PRINCIPLES AND PRACTICE OF COMMERCE

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INTRODUCTION

A KNOWLEDGE of the subject-matter of Commerce is of importance to us all. Those whose work is in the field of commerce are concerned with some specialised aspect of it, and they will be better fitted for their work if they have a conception of the whole picture of which their work is merely a detail. Those who are engaged in industry or in the professional services are still, in their work and as citizens, constantly dealing with the commercial world. Training in commerce is in a real sense training for living. All of us will at some time wish to open bank accounts or savings accounts, or to take out insurance policies. All of us shop for the things we want, use public transport services and communications, pay rates and taxes, and expect our bread, milk, mail and newspapers to be delivered to our door every morning. Few of us pause to consider what lies behind all these common features of our daily life. It is a function of the commercial system to ensure that they are available to us when we want them.

The products of our industries must be marketed and distributed to the ultimate consumers who are to use them. Our work, whatever it may be, is a minute contribution to the production or distribution of goods or services, and the work of many thousands of people must be co-ordinated and directed in order to ensure the production and delivery to the consumer of each article sold. In return for our work we receive a salary or wage with which we are able to purchase the product of many other people's efforts. Each of us is a worker and a consumer, and we shall be more enlightened and useful citizens in both of these respects if we understand something of the vast and complex system which turns our individual efforts into a variety of goods and services available for our consumption.

In the past century much thought, experiment and scientific knowledge has gone into the improvement of methods of production. As we have lost our position as leading manufacturing nation we have been forced to pay more attention to invention, mechanisation, cost control and work study in the factory and workshop. At present, with the development of automation and atomic power, visions of much greater productive power and cheaper production are opening before us, with the prospect of a much higher standard of living. This increase of potential production of goods, however, will avail us

nothing if the clerical and commercial services necessary to ensure the distribution of those goods do not keep pace with the expansion.

In the last few decades it has become increasingly apparent that the need for economy and for increased efficiency in the commercial field is just as important as it is in the productive function. Work study has been applied to the office, the warehouse and the shop; electronic machinery is beginning to produce the data on which the organisation of commerce is founded ever more quickly and in greater detail, and the commercial services must re-organise themselves to employ new methods and control costs with the same application that has been shown in the factory and workshop. The commercial scene therefore is changing fast; and this rate of change is likely to be accelerated in the near future. These changes are not likely in the immediate future to reduce substantially the vast number of people engaged in commerce but rather to change their functions. They should cut out much of the dull routine work which has gone on in offices in the past, but they will demand managements and clerical employees who have a wider knowledge of the ramifications of commerce and who can interpret and make use of the information which will be produced in greater detail and much more quickly.

It is realised, too, that these rapid changes in industrial and commercial methods will create problems of management which have not been met with before. Managements must move with the times also, those at the top on the technical side learning more of the problems of commerce and the commercial leaders learning more of the problems of production. There is still room for the highly-qualified specialist in a particular technique or function, but he must now become aware that he is part of a team and that the direction and co-ordination of the whole team is more important than the success and progress of particular specialists working in a vacuum. This in turn calls for a greater study of problems of human relations in persuading people to accept new methods of working and a greater sharing of burdens and problems.

SECTION I—GENERAL PRINCIPLES

CHAPTER I

THE SCOPE OF COMMERCE

COMMERCE is concerned with the exchange of goods; with all that is involved in the buying and selling of goods at any stage in their progress from raw materials to finished goods in the consumers' hands. It covers not only the functions of buying, selling and handling goods but also the many services which must be provided to finance, insure, store and transport goods in the course of these exchanges.

A self-supporting Robinson Crusoe on his desert island would know no commerce. His survival and his standard of living—which would certainly be very low—would depend on his unaided efforts exploiting the natural resources of his island and his own manual skill and mental ingenuity.

A family or tribal group exploiting its natural surroundings and having no intercourse with other groups would also not be concerned with commerce. It would probably develop a modest form of division of labour in that it would soon be realised that different members of the group had differing talents and that, if each man was assigned to the job he could do best, the total production of the whole group would be greater than if they each tried to be self-supporting individuals. But their total production would no doubt be pooled for the benefit of the group, and they would participate equally in the total product. There would be no question of exchange.

Once a number of such groups were in existence and began to exchange surpluses of production with one another, commerce would have come into being. Obviously these different groups would also no doubt develop different talents and be working in different natural surroundings so that the goods they produced would not be the same for each group.

The moment it was realised that all groups could have a higher standard of living and a greater variety of goods by concentrating on their specialised occupations and exchanging surpluses of production

over their own needs with one another, the basic pattern of commerce would emerge.

These earliest exchanges took place by barter—i.e. direct exchange of goods against goods, without money being involved. This is a crude form of commerce which obviously cannot be carried far. An exchange can only take place if both parties to the exchange derive satisfaction from it. This means that *A* must have an excess of goods over his own requirements which *B* wants, and that *A* must be satisfied with what *B* has to offer him in exchange for that excess. This is obviously going to lead to a hit-and-miss situation in which only a few of the potential exchanges will result in completed deals.

Apart from the question of both parties being satisfied, there is also another difficulty present in barter transactions, namely the difficulty of deciding what quantities of the two types of goods shall exchange for one another in order to satisfy both parties in the absence of any measure of value.

At this stage, therefore, commercial transactions were severely limited until a third commodity, rare in occurrence in relation to the demand for it but generally acceptable to all people concerned, was introduced as a medium of making exchanges. If such a commodity could be found which everybody would be prepared to accept in exchange for goods or services he supplied, knowing that when he came across someone having goods he wanted he could tender this third commodity in exchange for them and that it would be accepted, the first difficulty of barter was overcome. So was the second, inasmuch as the value of all types of goods could be expressed in quantities of the third commodity (i.e. priced) so that an exchange value of goods could be established.

Present-day money is the modern form of this third commodity, but in various communities and times in the past it has taken the form of shells, salt, cattle and precious stones or metals. At the turn of this century most countries still had moneys which consisted of precious metals, and these coins had an intrinsic value equal to their value as coins. Now token coins and banknotes which have an intrinsic value far inferior to their face value are used. Their value is a matter of public confidence in the banking system and national economy which backs them, but if this confidence is lost the coins and notes lose their value and a reversion to earlier forms of trading will result. In the liberated countries at the end of the last war in

the period between liberation of the country and the re-establishment of a national government and currency, quantities of tea, coffee, cigarettes, soap and foodstuffs were the best form of "money" for making purchases or obtaining services. In the immediate chaos of a defeated Germany these commodities were used when available, and when they were not, direct barter of goods against goods was resorted to.

From the introduction of this third commodity the stage was set for a vast increase in the amount of commerce. The opening of new territories, the improvement of means of transport and communication and the invention of new methods and processes of production brought about great extensions of commercial dealings and have led to the enormously complex system of exchanges between countries and peoples which exists today.

Not only finished goods are bought and sold. The raw materials from which those goods are made, the factory, warehouse and shop premises in which they are handled, the machinery and labour which are needed to make and distribute them and the various services supplied by specialists to facilitate manufacture and distribution are also bought and sold. Buying and selling functions concentrate at particular markets and Commodity Exchanges. Goods are produced in large quantities at factories and sold singly or in small quantities to ultimate consumers, giving rise to the functions of wholesaling and retailing as links between a large concentrated outflow and a widely-diffused consumption.

International trade involving the movement of goods across national frontiers and between areas of different currencies, involves Government departments in the organisation of trade. Commercial treaties must be negotiated at Government level and tariffs, quotas, customs duties and currency restrictions may all impose limits on possible trade movements.

Production and distribution must be planned and directed. Markets are investigated, potential demands measured and new demands created by the use of market research and advertising techniques.

Goods must be transported and warehoused. Producers, wholesalers and retailers must be financed and, finally, many of the risks attaching to business must be lifted from the shoulders of those concentrating on producing, transporting, warehousing or selling goods, by the provision of insurance facilities.

These are the broad areas which are covered by the subject of Commerce and which must be studied in some detail.

There is a wider area of subjects generally treated as "Commercial Subjects." Accountancy is the function of recording the activities of a business and determining the progress and the profits and losses of trading or manufacture. Recent decades have seen a great increase in the importance of the accounting records as attention has been turned in ever more detail to cost factors, and the accountant's function which until recently was mainly historical is now projected forward to plan targets of production and sales and to plan in detail future activities of a business through budgetary control.

Shorthand and typewriting are skills largely used for commercial activities.

The particular aspects of law which govern the formation and regulation of business units, the making and enforcement of contracts, and the relations between principals and agents are collectively referred to as "Commercial Law."

The study of Economics takes students through much of the same territory as a study of Commerce will. But whereas Economics deals with the broader theory governing productive and distributive activities, international control of trade movements and the planning of national economies, Commerce is more directly concerned with the practical execution of the activities eventually decided upon.

These are all subjects which are intimately and directly connected with the subject of Commerce. In a broader sense most of the normal school subjects make their contribution to the subject-matter of Commerce.

The distribution of raw materials and the climatic regions studied in Geography are the primary determinants of the distribution of manufacturing, mining and agricultural activities in different parts of the world, and hence of the nature of the trade movements from one part of the world to another. Geographic factors also determine population concentrations and the siting of towns and ports.

History tells us of the evolution of peoples and societies, of inventions and the developments of transport and communications. The systems and methods of commerce follow these developments and are a direct result of the needs to which they give rise.

Mathematical calculations enter directly into production, and in

the field of commerce measurement of markets and of the progress of business is made by the use of accounting and statistical data. Production and sales targets and the control of businesses are based on this type of information.

English is a means of communication for social and business intercourse. In advertising, in the making of business contracts, and in the verbal and written communication of information between firms it is important that there should be clear and precise expression understood by all the parties concerned.

Similarly an understanding of foreign languages is necessary for the conduct of international trade. British export businesses are becoming increasingly aware that in the competitive conditions now existing the advertising of goods and the conduct of sales negotiations with other countries demand an approach in the language of the particular market they wish to enter.

It will be appreciated therefore that Commerce is a very wide subject which overlaps into many other subjects and studies. The subjects which form the normal school curriculum all lead up to the basic fund of knowledge and the processes of thought and reasoning which are needed by the future citizen and worker. In these two latter capacities the student will find, whatever his actual occupation may be, that his activities will constantly bring him into contact with the world of commerce.

CHAPTER II

FUNDAMENTAL NOTIONS

IN the study of commerce, it is necessary that the student should first make himself acquainted with the principal terms used in economics. The following are some of the most important—

WANTS.—The function of human want is self-preservation, or the attainment of a higher state of development. The first aim of human existence is to obtain a sufficiency of the means of life. It is necessary to feed and clothe oneself, to procure fire and shelter, and to obtain those necessities without which life would be intolerable. The existence of want signifies that persons are in a state of desiring more of certain commodities, and the greater the desire the more urgent is the want. The existence of want leads to exertion and the endeavour to satisfy such want; hence there arises a human struggle for existence and for the attainment of a state of well-being. Amongst the rudest and most uncivilised peoples wants are merely a means of self-preservation, whilst among others they are the means to further development. The intensity of the wants is measured by the degree of dissatisfaction created by them in man, and also by the quantity of goods which are required for the satisfaction of such wants.

GOODS.—Human wants are satisfied by means of goods, and goods are said to possess greater or less utility according to their power to satisfy human desires.

If nature supplies a "good" free, it is known as a non-economic good. If it satisfies a want and can be obtained only by human exertion, it is an economic good. Economic goods consist not merely of material things, but also of immaterial, i.e. they may be the result of labour, but do not assume a tangible form. For our present purposes only those goods which are transferable are classed as economic goods. They consist of—

(*a*) *Non-material Goods*, e.g. services and intangible things such as goodwill.

(*b*) *Material Goods*, i.e. those things which assume a tangible form; such as houses, food, clothing, and machinery.

(*c*) *Paper Values*, i.e. goods which assume the form of paper and

represent rights over other forms of wealth. These are subdivided into (1) documents of title, and (2) paper money. Documents of title include any bill of lading, dock warrant, warehouse-keeper's certificate, and any other document used in the ordinary course of business either—

(i) As proof of the possession or control of goods, or

(ii) As authorising or purporting to authorise, either by endorsement or delivery, the possessor of the document to transfer or receive goods thereby represented.

(*d*) *Coin.*

These four classes of goods constitute the commodities of commerce.

MEASUREMENT OF GOODS.—In the execution of commercial transactions it is necessary to have some contrivance by which the weight, length, surface, volume, capacity, and value of different goods may be compared. For this purpose some standard of comparison must be chosen, i.e. a common term which will enable two commodities to be measured and their attributes compared. In the British Isles, the standards of weight are the ounce, pound, hundredweight, and ton ; of measurement, the inch, foot, yard, and mile ; the pint, quart, and gallon ; whilst the standard of value is the pound sterling.

A good system of weights and measures ought to have the following qualities—

1. *Accuracy.* The standard of measurement or of weight should have exactly the same qualities as any other standard of the same nominal value.

2. *Uniformity.* The same kind of weights and measures should be in use all over the country in which they have been adopted.

3. *Simplicity.* The system of weights and measures should be easily understood if it is to be of any real value in facilitating the exchange of goods.

4. *General Acceptance.* The weights and measures in use should be as widely known as possible. Many countries now use the metric system of weights and measures, and this is of great advantage to traders in such countries.

5. *Facility of Calculation.* The weights and measures adopted should be simple in calculation so that there shall be no undue waste

of time. It has long been admitted that the British weights and measures do not possess this quality.

VALUE.—This is a relative term and refers to the quantity of some other thing for which a commodity can be exchanged. A particular commodity is usually chosen to measure the relative values of other commodities, and this is known as money. The estimation of the value of another commodity in terms of money is known as the "*price.*"

ENTREPRENEUR.—In most business concerns it is the practice for one class of person to supply land, another capital, and another labour. The task of co-operating these factors is performed by the entrepreneur whose position in modern business is so important that it is necessary to regard him as a separate factor. He is the undertaker of business risks, and has to pay rent for his premises, interest on his capital, and wages to his workmen, perhaps long before he has produced the article which he intends to sell at a profit.

The entrepreneur of a sole trading concern ought to be so far master of each section of his business that he can judge the efficiency and actual work of each of his employees, the quality of the raw materials, the efficiency of the plant, machinery, etc., as well as the condition of the finished and half-finished productions. At the same time he ought to have sufficient commercial education to guide him in his speculation, to enable him to anticipate expenses and output as closely as possible, and to render it possible for him to avail himself of the conditions of the market. Further, he should be able to compare the relative value of his own work with that of his competitors, to survey the ruling tendencies of the markets, to keep in touch with public taste, and to foresee economic crises. The importance of these different phenomena increases with the development of the undertaking, whereas in very small concerns the labour power of the entrepreneur and his family is often adequate for the conduct of the business. Every enlargement of the concern means the creation of a new activity which is handed over by the principal to a subordinate. The separation of functions has been carried so far that in many concerns the class bearing the risks of the enterprise are clearly separated from the organisation. The entrepreneur of a sole trading concern or partnership combines the functions of the organiser, of the capitalist, and of the undertaker of business risks. In a joint stock company, however, it is

usual for the organiser to receive a fixed fee and for the risks of the enterprise to be borne by the shareholders. Hence, the shareholders are, in the strictest sense, the entrepreneurs of a company. In such concerns the responsibility of organisation is usually delegated by the proprietors to a managing director, who is rewarded by the payment of a fixed fee. In the case of a Co-operative Distributive Society, the entrepreneurs are the consumers themselves since they contribute the capital and undertake the risks of the business. In the case of a municipal undertaking the risks are undertaken by the ratepayers, and therefore they exercise the function of the entrepreneur.

DEMAND.—The expression "Demand" usually refers to the totalled desires, expressed in terms of money, that a number of persons will give to obtain possession of a commodity. An individual may desire to possess an article, but unless he has the means with which to purchase it, his demand will not be effective. The only demand with which economists are concerned is "effective" demand, or the demand which will cause a commodity to be produced and to be put upon the market. Effective demand is further divided into "demand in the abstract" and "demand in the concrete."

Demand in the abstract means the desire to possess coupled with the power to purchase, and concerning demand of this kind the question to be asked is whether there is or there is not a demand for a particular commodity in the community. It may be said that there is a demand for bicycles in England, because people are desirous of possessing them and are willing and able to pay for them. This is abstract demand. Concrete demand is the desire to possess an article *at a price*, and indicates the quantity of the article which will be bought at the price. There may be not only a demand for bicycles in England to-day, but there may be a demand for 10,000 bicycles at £20 each, which would be demand in the concrete.

Elasticity of Demand. When a small change in the price of a commodity causes a great change in the amount bought, the demand is said to be *elastic*. For example, if a commodity is offered at 2s. and fifty people purchase it per week, and the price is lowered to 1s. 11d., and 200 people buy it, then the demand for that commodity is elastic.

law of the market known as the Law of Indifference, which says there can be only one price in the same market. Jevons enunciates this law in the following words: "*In the same open market at any one moment there cannot be two prices for the same kind of article.*" *This law depends upon the absence of any form* of monopoly, and also on the degree of divisibility of the particular commodity. If every portion of the supply is equally available to the buyer there is no reason why he should pay 2s. 6d. for something which he can purchase for 2s. In the same market, then, there must be only one price.

People sometimes dispute the operation of this law. They say the same article can be bought at different prices at different places. But these different places are separate markets according to the definition given above. The supply which exists in one place may not be available equally to the demand which is experienced in some other place, and hence the difference in price. The supplies exist in different markets.

MARKET AND NORMAL PRICE.—If an entrepreneur sees a probability of getting a price greater than the total expenses of production, he will increase the output of that particular commodity; but if he thinks he will not get as much as the total expenses of production, including a fair profit, then he will restrict the output. The cost of production of a given quantity of the supply determines the least the sellers can profitably afford to take, and the intensity of the demand for the commodity the most buyers will give. When the demand price is just sufficient to carry off the available supply at this minimum or supply price, demand and supply being in equilibrium, the point of normal price is said to have been reached. If the producer takes less than this normal price he will incur a loss or make no profit, whereas if he takes more, he will receive more than the average rate of profit.

The market price continually varies about this normal price or point of equilibrium. If demand is greater than this supply then the market price is greater than the normal price, and vice versa.

Thus supply, demand, and price are three great forces in equilibrium, i.e. the triangle of forces mutually acting and reacting upon one another, so that the smallest change in one at once effects a change in the other two.

These remarks concerning demand, supply and price, apply to the

system of supplying goods by free enterprise, i.e. in the absence of central planning and direction by the Government. Their full operation presumes that there is full liberty for producers to enter or withdraw *from a given occupation and that all suppliers and all those demanding the products are acting on their own behalf and in their* own interests. Monopolies, near monopolies, groupings of suppliers or consumers, or any other devices used to bring influence on the movement of prices will modify the operation of the tendencies outlined.

CONTRACT.—A valid contract is an agreement and promise enforceable at law. For the existence of such an agreement there must be—

(1) An offer;

(2) An acceptance of the offer; and

(3) A certain binding force attached by the law to enforce the promise thus formed. This force creates what is called an obligation or legal bond, which, when broken, causes the contract to be discharged.

Offer and Acceptance denote two or more persons being of one mind, otherwise no agreement ensues. Doubt or difference is not possible where there is agreement. The offer must be accepted before any contract is made. Both parties must have the intention communicated to them, and the agreement must be such as to affect the legal relations of the parties.

A contract is, therefore, an agreement enforceable at law between two or more persons by which rights are acquired by one or both parties to acts or forbearances by the other or both.

The Essentials of a Contract are as follows—

(1) A distinct communication by the parties to each other of their full intentions, the one to offer and the other to accept that offer in full without any restriction not expressed in the offer.

(2) The presence of evidence sufficient to show that the parties wished to affect their legal relationship. This takes one of two forms—

(*a*) Form, e.g. a contract under seal.

(*b*) Consideration, i.e. some gain or profit to the party making the promise in return for his promise. For instance, A and B agree that A will sell his horse to B for £60. Hence, £60 is the consideration for the horse.

(3) The parties must have legal capacity to contract.

(4) Offer and acceptance must be genuine.

(5) The objects of the contract must be perfectly legal.

When these five elements co-exist the contract is valid. The absence of one of them makes the contract void, voidable, or unenforceable.

A Void Contract is destitute of legal effect and neither one party nor the other can enforce it.

A Voidable Contract is capable of being carried out or not, at the option of one of the parties to it.

An Unenforceable Contract is perfectly legal, but being incapable of proof in a Court of law through some technical defect, it is called a contract of imperfect obligation, and is in the true legal sense no contract at all.

In general, all persons may be parties to contracts, but no person can contract with himself in a different capacity, as there must be an agreement of minds. Furthermore, parties must be capable of contracting at the time they enter into the undertaking, for without capacity there can be no assent, and no understanding. Hence, before a party can bind himself to a contract, he must be able to understand its nature. When one of the parties is mentally incapable of contracting, the contract is void. Beside the requisite of capability, parties to contracts must *exist.* If they purport to be natural persons, they must be living. There can be no legal contract with a *fictitious* person. In the case of an *artificial* person, such as a corporation, it must have a legal existence to entitle it to contract.

Persons with defective capacity to contract are (1) infants, (2) aliens, (3) insane and drunken persons, and (4) corporations. In all these cases, however, there are qualifying circumstances.

TEST PAPER

1. Explain the function of " want " in the economic system.
2 Distinguish between " economic " and " non-economic " goods.
3. What qualities should be possessed by a good system of weights and measures ?
4. " Value is a relative term." Do you agree with this statement ?
5. Explain the relation of the " Supply " of a commodity to its price.
6. What is meant by " Elasticity of demand " ? Mention cases of commodities the demand for which is " inelastic."
7. What is the function of the *entrepreneur* in modern business ?
8. Describe a perfect market. Give examples of both perfect and imperfect markets. Discuss the case of the Labour Market.

9. Distinguish between "market" and "normal" price.

10. What are the essentials of a valid contract?

11. Explain how every agreement can be analysed into an "offer and an acceptance."

A gets into an omnibus, and, after travelling some distance, pays his fare and gets out. Show that there was a contract between the 'bus company and *A*, pointing out the "offer and acceptance."

12. Give three instances of persons who do not possess full contractual capacity.

CHAPTER III

AGENTS OF PRODUCTION

AGENTS OF PRODUCTION.—It has been seen that the economic activity of man is directed towards the production of goods; this production is the conferring of utility on materials supplied by nature, with the object of satisfying human needs. The leading motive in production is the economic consideration which aims at the creation of maximum utility with the minimum expenditure of effort, and a business is said to succeed economically when the value of the return is greater than the total value of the efforts incurred when measured in terms of money. An undertaking is, therefore, productive in the economic sense when it creates new values or increases the values of already existing goods. Hence it will be seen that not only are the extractive and manufacturing operations productive, but also the activities between production and consumption, viz. commerce. The chief requisites in production are the resources of nature and human labour, and capital, without which the creation of wealth is scarcely possible. The last-named factor is of great importance at the present day. These three agents—nature, labour, and capital—are often spoken of as the "factors of production," labour often being referred to as the personal, and nature and capital as the material, factors.

NATURE.—The whole of production is, in the last resort, dependent upon nature. Of the greatest importance to industry are climate, land, and the distribution of water, for by them is largely determined the character and extent of a country's production.

Climate depends chiefly upon the position and configuration of the country. Continental places are subject to greater extremes and smaller rainfall than districts situated near to the sea. For instance, in Russia the rivers and seaports are closed for months in winter by ice, while those of the Atlantic coast in corresponding latitudes are always kept open by the influence of the comparatively warm sea-water. Climate has a direct influence in determining the variety, the quantity, and the quality of products in a given area; and indirectly, it exercises an influence upon the nature and extent of man's needs. A further effect is its determining

influence on the disposition and character of man, which reacts upon his power to exploit the resources of nature.

The chief natural factor which enters into production is *land*, for it serves as the home and the workshop of man. In an agricultural community it determines the entire economic and social relations of the people. The configuration of a country, i.e. the form and arrangement of its mountains, valleys, high and low lands, determines the size and directions of its rivers, and the value of its soil for cultivation. In many countries, the State pays particular attention to the cultivation of the soil, and seeks to develop the efficiency of this factor through legal and economic measures. In this respect may be mentioned the various forms of land ownership which exercise an undoubted influence on the total product of industry. In production, not only is the fertility of the soil and its suitability for agricultural purposes important, but also its riches in minerals and natural power. A discovery of gold, silver, or oil may bring a rush of people to a barren region, difficult of access. While these natural deposits last, railways are constructed, the soil is improved for agriculture, and towns are built ; and when the supply is exhausted the result may be a self-supporting settlement permanently established and in full communication with the world. Thus, the position and industries of large centres of population are usually determined by the existence of natural resources.

The economic importance of *water* consists partly in the existence of the water itself, and partly in the useful things contained therein, such as common salt, fish, and plants ; and partly in its capacity for transport and as power for the conduct of manufactures. Water is one of the most important of the necessities of life, and human settlements are only possible where it exists or can be obtained in sufficient quantity and of good quality. Moreover, in consequence of its varying constituent properties, its existence in certain qualities is important for the conduct of brewing, fishing, dyeing, tanning, and for purposes of healing certain maladies.

Thus, the production of a country is due largely to the existence of natural resources ; the nature of the climate ; the relief of the land ; the fertility of the soil ; the geological formation ; the configuration of the coast-line, and situation with regard to other countries.

LABOUR.—Labour is the application of the mental and physical

quite a number of different conceptions. To the business man it indicates a sum of money lent out at interest, or it may bring to his mind the actual form which capital assumes in a business; such as land, buildings, machinery, money, or claims upon debtors. Likewise, in a scientific sense, the term "Capital" has many different meanings.

Production Capital. In the first place, it will be well to examine the meaning and function of capital as a factor, along with labour and natural resources, in the production of wealth.

If the student will recall to mind any examples of production with which he is acquainted, it will be seen that human effort seldom, if ever, operates directly upon the materials freely supplied by nature. In the production of most goods, some means of assistance to hand labour is provided in order to get the best results. The most important of such auxiliaries are the many kinds of tools and implements which have been brought into use by man through many thousand years of development, ranging from such primitive forms as the stone axe to the complicated automatic machinery of our modern factories. Labour is further assisted by the already existing supply of raw materials, the building in which manufacture and construction take place, the transport facilities, by means of which raw materials are conveyed to the place of manufacture or of consumption, the improvements of the soil by, e.g. drainage and fertilisation. All these means of assistance are the results of past labour which have been saved up and can now be used to assist further production. They include every description of assistance to man's labour which has not been supplied freely by nature.

Capital then can be deemed to be the sum total of those means which co-operate with man in the production of wealth, which are not freely given by nature but are themselves the product of human labour. Capital co-operates in every stage of production, irrespective of the legal relations of the persons using it, or whether it be owned by an individualistic or by a socialistic undertaking. In this sense it is known as Production Capital, which is the ordinary use of the term in economics.

Forms of Production Capital. Production Capital assumes many different forms, the chief of which may be grouped as follows—

(1) Raw materials; such as corn, flax and ore, out of which are made flour, linen, and iron.

(2) Auxiliary materials which are used in production without forming a visible part of the new product; e.g. coke in the smelting of iron, and manure in agriculture.

(3) Implements of production; such as tools, machines, utensils, etc.

(4) Buildings in the service of production; such as dwellings, factories, workshops, stables, warehouses, waterworks, etc.

(5) The system of exchange, together with the institutions connected therewith.

(6) Improvements of the soil; such as drainage and irrigation schemes, which render production more efficient.

(7) Transport facilities.

The greater the number of such forms of Production Capital, the more varied is the output of new goods. The stock of Production Capital existing at any given moment of time determines the output of the immediate future. It is, therefore, of great importance for the general welfare of the whole population that the stock of Production Capital should not be permitted to diminish, but should be repleted according to the amount consumed in the process of production. The increase or diminution of capital in a community is a matter of great economic significance.

Revenue Capital. When it is regarded, not from the point of view of production, but from that of the individual, capital has a different meaning. According to this meaning, capital is that wealth which enables its owner to earn an income, and is known as Revenue Capital. The utilisation of wealth with the object of earning an income presupposes an economic system based upon exchange, and the existence of private ownership as a legal institution.

Fixed Capital is that which can be used a number of times without complete exhaustion of its utility, but from which the value of each use goes to increase the value of new products—for example, buildings, machines and tools.

Circulating Capital is that which is completely changed in form or consumed by one use, its value passing over entirely into the new product—for example, stocks of raw materials or finished goods, cash and bank balances.

The difference between Fixed and Circulating Capital may be further illustrated from the following simple Balance Sheet.

BALANCE SHEET

Liabilities.	£	*Assets.*	£
1. Share Capital . .	500,000	1. Land . . .	100,000
2. Reserve Fund . .	285,000	2. Buildings . .	50,000
3. Creditors . .	300,000	3. Machinery . .	200,000
4. Bills Payable . .	70,000	4. Implements . .	10,000
5. Undistributed Profit .	50,000	5. Office Fittings .	1,000
		6. Raw Materials .	120,000
		7. Finished Goods .	80,000
		8. Debtors . . .	530,000
		9. Bills Receivable .	60,000
		10. Cash . . .	54,000
	£1,205,000		£1,205,000

The Assets side of the Balance Sheet indicates capital in a certain state of liquidity, whilst the Liabilities are indicated according to their origin.

According to the form of assets, capital may be grouped into two large classes. Nos. 1–5 are Fixed Assets, since they are intended for permanent use in the business. Nos. 6–10 are items of capital, which are not for permanent use, but form part of the turnover. They are known as the Circulating Capital. By turning over the Circulating Capital, profit can be made.

The Liabilities side shows how the capital has originated. It is made up partly of the undertaking's own capital (Share Capital, Reserve Fund, Undistributed Profit), and partly of outside items (Creditors and Bills Payable). The former is the only capital which is at the disposal of the business for a long period of time, whilst the latter may be regarded as short period obligations.

Social Capital. This refers to those possessions which can be regarded as the " Capital " of a body of persons, such as a municipality or nation, but not of any particular individual. Parks, public libraries, picture galleries, etc., are examples of the Social Capital of a municipality, whilst the nationalised industries, the Post Office, the telephone and telegraph services, are part of the Social Capital of the nation.

Capital from the Accountant's Point of View. Capital as viewed by the accountant is an amount of wealth ventured by the proprietors of a business for the purpose of carrying out some enterprise.

The capital subscribed in the case of an ordinary business concern has to be accounted for to those who have subscribed it, whether

there be one or many. It is for this reason that capital is treated as a separate entity in the books of a firm.

The business which starts with no property or obligations of any kind is first supplied with wealth in the form of capital, for which a corresponding obligation to the subscribers is shown in the firm's books. Then comes the question of the administration of this wealth which has been acquired for the purpose of the business. The business operations will consist almost entirely of the exchange of commodities of different kinds with the object of making a profit. This process involves a continual exchange of goods, and some of these exchanges will be advantageous and some will be disadvantageous, so that the actual capital of the undertaking will be a continually varying quantity. By the aid of credit operations the business house will be able to acquire a considerable number of commodities without giving anything in exchange for them at the time, except an undertaking to pay for them later. As soon as the operations of the business begin, the tendency will, therefore, be not merely to exchange the capital subscribed for commodities, but the business will also acquire other commodities in exchange for the obligation to pay for them at a later date.

Hence, it may be supposed that a firm starts with no assets and liabilities, and after the capital has been subscribed there is a liability to the subscribers on the one hand, and an equal quantity of commodities on the other hand. Very soon the stage is reached when the value of the commodities exceeds the capital, since some of the goods are purchased on credit. There will then be further liability towards the parties for the commodities acquired. However, the total value of all assets will at all times equal the total values of liabilities, although the totals will, in fact, be continually varying. The aim of the business is continually to effect exchanges which will be to the advantage of the firm, and in this process *profits* will be made. The commodities bought for a certain amount will be exchanged for a larger sum, and thus the total of the assets will be increased without effecting any corresponding increase in the firm's liability to strangers, or increasing the original amount of capital subscribed by proprietors, but not without increasing the total amount of the firm's liabilities. It must be remembered that the business has to account not merely for the capital originally contributed by its proprietors, but also for all the profits made out of

the administration of the capital, so that every time the administration of capital results in an increase of assets, the process involves a liability to account to shareholders for an equivalent amount of profit. The total amount of assets possessed will always equal the amount of liabilities to all parties and these may be subdivided into—

(1) Those to be accounted for to strangers.—The "external liabilities."

(2) The amount of capital originally ventured by the proprietor.

(3) Liability for profits earned.

It may be convenient to think in terms of subtracting the amount of the external liabilities from the assets and then to speak of the remainder as representing the net assets available to meet the capital and profits.

The object of conducting a business is to earn profits for the advantage of the proprietors, and therefore the normal attitude of the proprietors towards these profits is that they are entitled to withdraw them for their own private purposes. Some concerns, however, find that the demands for further capital in the business can best be met by the distribution of only a part of the accrued profits, the remainder being retained in the business. Hence these retained profits become a part of the business capital.

Again, it does not necessarily follow that the various proprietors will be entitled to share profits in exactly the same proportions as those in which they have shared capital. In the case of a sole trader, one person only is interested in the profits, but in the case of a partnership each member subscribes according to mutual agreement. The law of partnership provides, however, that, unless there is an agreement to the contrary, each partner has a right to share equally in the profits with the other partners. This is a recognition that it is not capital alone which creates profits, but capital in combination with brains, and therefore the amount of capital subscribed is by no means necessarily the only factor which determines the reasonable distribution of profits. Unless partners are willing to divide the profits equally they must make such an agreement in advance.

In the case of companies where the individual shareholder does not, as such, take any part in the active management, and the

management of the business is in the hands of the directors who are paid fees for their services, the assumption on the part of the law is that profits will be divided *pro rata* among the members. Every company is allowed to make its own internal regulations, but in default of its making any regulations, a schedule known as Table A applies, and this contemplates that profits are to be divided among the members in proportion to the amount and class of the capital which they have respectively subscribed.

Proprietor's Capital. A considerable proportion of the capital employed by business enterprises must be found by their proprietors. In the case of a sole-trading concern, the capital will usually be provided by the founder of the business from his own savings. This capital will be increased by the profits and diminished by the losses of the business. In the case of the partnership the position is exactly the same except for the fact that each partner has his individual capital account. In addition to the direct investment of capital by the owners of a business, capital may also be provided by allowing profits to accumulate in the business, usually in the form of reserves, or in the form of an undivided balance of profit and loss account.

In the case of the public joint-stock company, the capital is usually raised by an appeal to the investing public for subscriptions. Such companies divide their capital into a large number of fractional parts called shares, each one of which has usually the same nominal value, the most common denomination being one pound. The rights which attach to the owners of these shares vary according to the conditions laid down by the company at the time of issue, and it is open to the company to issue more than one class of share. The following are the chief classes—

1. *Non-cumulative Preference Shares.* These rank first as to payment of dividend and sometimes as to return of capital. Preference shares may be issued carrying the first of these preferences only, but if they carry both, then (*a*) the fixed rate of interest attached to the shares must be paid out of profits before the ordinary shares rank for dividend; (*b*) in the event of the company going into liquidation, preference capital has the right to prior payment before other classes of shares, should funds for repayment be available after payment of external debts.

These shares carry a preferential right to dividend out of the

has of the trader receiving it. This method may appear to be an easy way of obtaining working capital, but very frequently it proves expensive. The person advancing it may recoup himself by charging an extra price for the goods which he sells, or by demanding other concessions.

TEST PAPER

1. What are the agents of production? Explain how "Nature" aids in the work of production.

2. "Man creates utilities, not things." "Production consists in the creation of values." Explain these quotations, bringing out clearly the function of Labour.

3. Discuss the following statements—
"Production is controlled by the capitalist."
"Production is controlled by the *entrepreneur*."
"Production is controlled by the receivers of income"

4. "Modern production is group production."
"Production with capital is a roundabout process."
Explain and discuss these statements in relation to each other.

5. It has been said that "division of labour" implies "combination of labour." Consider the relation between division and combination of labour, with special reference to the way in which each tends to develop the other.

6. In what respects does Labour differ from a commodity, and the Labour Market from a market for goods?

7. Give some of the reasons—other than habit and want of intelligence—why division of labour is not carried much further than is actually the case.

8. Sketch shortly the chief features of the actual "Division of Labour" existing in any modern society. How far is there "international division of labour"?

9. Explain the meaning of the terms "Money," "Wealth," and "Capital."

10. If shown a certain commodity and asked whether you regarded it as capital or not, what information would you desire to obtain about it before giving your reply?

11. Explain the difficulties in the use of the word "Capital."

12. Describe "Capital" from the different points of view; as: production and revenue; fixed and circulating; social and individual.

13. Illustrate the bearing and importance of capital upon the production of wealth by reference to the economic conditions of—
(*a*) England and India.
(*b*) Australia in the present day and 100 years ago.

14. Draw up a simple *pro forma* balance sheet of a trader which will show at a glance: (*a*) The amount of capital employed in the business; (*b*) the amount of fixed assets; (*c*) the amount of floating assets; (*d*) the amount of external liabilities; (*e*) the amount of capital owned by the trader.

15. Into what kinds of shares may the capital of a company be divided?

16. Consider briefly how a trader may obtain additional capital for a permanent expansion of his business. Would he necessarily adopt the same means if the expansion were intended only to be temporary? If not, why not?

SECTION II—INDUSTRY

CHAPTER IV

THE CLASSIFICATION OF OCCUPATIONS

The first test to apply to the economic condition of a country is the level of its annual production of goods and services. The Gross National Income for the United Kingdom in 1955 was £16,784 million. This means that if the rent of every landlord, the profits of every employer, the interest paid to every capitalist, and the money value of the paid labour which is earned were all added together the total would amount to this sum. To achieve this result there is required an infinite variety of labourers, all of whom are engaged in industry and are endeavouring to increase the values of materials or of services. All such persons are producers since they assist in so transforming the resources of nature as to render them suitable for the satisfaction of human wants.

At the beginning of the nineteenth century, writers on economics used the word " production " in a very narrow and erroneous sense. They classified labour as " productive " if it resulted in increasing the value of materials, and unproductive if it did not. A tailor was productive because the clothes he made were of greater value than the cloth; but many people such as bankers, insurers, lawyers, teachers, etc., were regarded as " unproductive." Modern writers, however, consider that all these classes of the community are productive, since they increase the efficiency and save the time of the more directly productive workers. The banker helps to finance, and the insurer to remove risks from, the activities of productive workers; the lawyer decides their disputes; the teacher improves their intellects, etc. Production may therefore be summed up diagrammatically as shown on the next page.

It will be seen that the desire to satisfy a human want is the mainspring of the efforts which are put forth in the production of commodities. On account of the advantages derived from the division of labour, human effort manifests itself in a multiplicity of activities which have, in the course of time, become separated into

HUMAN WANTS
are satisfied
by
PRODUCTION

- INDUSTRY
  - EXTRACTIVE
    - Hunting
    - Fishing
    - Mining
    - Agriculture
  - CONSTRUCTIVE AND MANUFACTURING
    - Engineering
    - Building
    - Weaving
    - Metallurgy
    - Production of consumer goods
- COMMERCE
  - TRADE
    - Buying and Selling raw materials, semi-manufactured and finished goods
    - Export/Import
    - Wholesale/Retail
  - COMMERCIAL SERVICES
    - Banking
    - Insurance
    - Transport
    - Warehousing
    - Market Research
    - Advertising
- DIRECT SERVICES
  - Teacher
  - Soldier
  - Lawyer
  - Doctor,
  - etc.

distinct callings. The whole of these productive activities may for convenience be divided into three great divisions—Industry, Commerce, and Direct Services.

EXTRACTIVE OCCUPATIONS.—These are engaged in supplying those commodities which are supplied by nature and exploited by man, and are merely obtained in order to be used directly or are further worked up by the manufacturing industries.

MANUFACTURING AND CONSTRUCTIVE OCCUPATIONS.—These consist of occupations which are concerned with the working up of raw or partly finished materials into finished articles or in putting together already existing materials. Manufacturing undertakings aim at producing a change in the raw materials, in order to increase their values, and also work mechanically the transformation of goods. Among such undertakings may be mentioned iron-works, breweries, flour mills, the making of machinery, boiler-making, china and porcelain works, weaving and spinning. As opposed to these are the constructive undertakings, which include the sinking of shafts, the laying of roads, railways, and cables, etc. These have reference to the building of, and the fitting, connecting, and completion of materials which are already prepared.

COMMERCIAL OCCUPATIONS.—This branch consists of all those activities which have for their object the exchange of goods between the extractor and the manufacturer, or between the manufacturer and the consumer. The function of commerce in the industrial organism is to bind together the different sections of production by procuring the exchange of their commodities according to the principles of economy. The occupations included under the heading

of commerce are engaged in effecting the exchange of goods between producers and consumers, and in seeing to the transport and insurance of the goods. Commerce must, therefore, be regarded as the last link in the chain of productive activity.

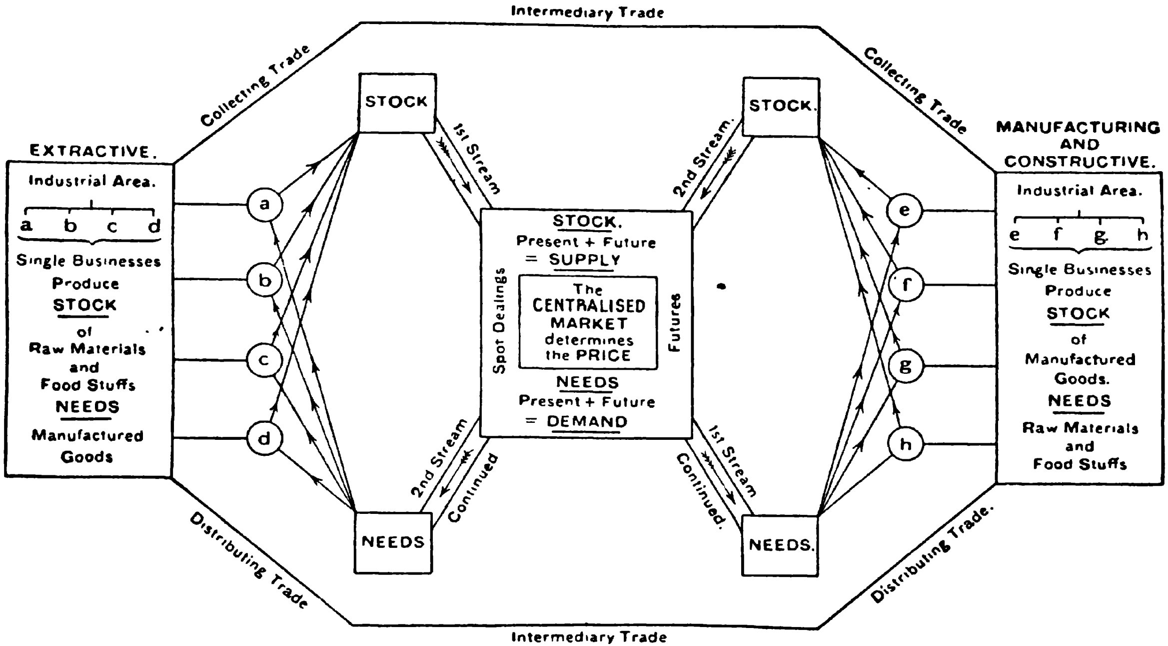
PERFORMANCE OF DIRECT SERVICES.—This group of occupations includes all those which are engaged in increasing the efficiency and in saving the time of the more directly productive workers, but are not themselves engaged in the production of material commodities. Among such occupations are those of a protective type such as soldiers, sailors, policemen, etc. This group also includes those engaged in intellectual pursuits, such as teachers, lawyers, musicians, etc.

INTERDEPENDENCE OF OCCUPATIONS.—From the diagram on page 32 it will be seen that the two main feeders of the world's commerce are the extractive and manufacturing industries, which are dependent upon each other in the production and consumption of goods. In commerce, each separate business appears in a two-fold manner—in the first place, as a supplier of marketable goods and services, and, secondly, as a receiver of goods and services; in the former case acting as a seller and in the latter as a buyer. Every business undertaking is a producer to the same extent as it is a consumer, and pays for the products it receives by supplying an equivalent amount of goods or services in exchange. Hence there exists a kind of set-off between production and consumption.

The exchange of goods between the persons engaged in the various branches of industry is only possible by the establishment of a special organisation, and it matters little whether this organisation is connected with the manufacturer or the consumer or whether it is effected by a specialised person such as a merchant.

The commercial organisation has to act as a link between the direct producer of the goods and the consumer in the fixing of the price. It fixes the payment to be made to the supplier of the goods in terms of money, and on the other hand it determines the purchasing power of the consumer. At the present time this function of determining price is fulfilled through the medium of the market, where one merchant represents the offer of the goods on behalf of the direct producers, which is known as supply; and another merchant represents the needs of the consumers, which is known as demand. Therefore, the price is arrived at by the

THE CLASSIFICATION OF OCCUPATIONS



competition between the agents of the producers and consumers, or by what is sometimes referred to as the " higgling of the market." The probability that future stocks are likely to be brought on to the market will tend to lower present prices just as a probable increase of future prices will tend to raise present stocks. The effect of these two streams, i.e. future demand and supply, is the production of a continual fluctuation of prices which are lowered when supply is enlarged and raised when demand is more intense, until the higgling of prices brings about a point of equilibrium through the operation of economic forces.

Concrete Example. An analysis of the processes whereby a woollen vest comes into one's possession will reveal the fact that we owe it to more than one occupation that we are able to procure such an article. We may imagine that the raw wool is produced in Australia by a large number of individual farmers—*a*, *b*, *c*, *d* in the diagram—all of whom are engaged in an extractive industry. The wool in question once adorned the back of a sheep on the Darling Downs. The owner of the sheep had combined capital and labour and organisation to set his sheep run going. Eventually after clipping time we may imagine him arranging to rail the wool to Sydney, where buyers of many nations would compete at the sales for the raw material. Our wool having been sold to a British representative, now forms part of a cargo which is transported to London, where it helps to increase the total supply received from other parts of the world. Banking facilities, insurance, warehousing and transport all play their part in ensuring that the wool shall reach the British buyer. These component parts of the great organism—commerce—are set in motion to overcome the obstacles which exist between the seller in Sydney and the buyer in London—the obstacle of place, i.e. by transport and insurance which ensures safe and speedy change of locality of the goods, and the obstacle of time, that is by warehousing in its broad sense. Arriving in London, the demand for the total supply of wool will proceed from the separate businesses engaged in wool spinning—*e*, *f*, *g*, *h*—in the diagram. In the determination of price, both the actual and the anticipated or future demand and supply enter into consideration. The interaction of the forces of demand and supply will determine the price of the raw wool on the London Exchange. The woollen manufacturer by bringing together the necessary factors of production is in a position

to produce a cheap garment of a different type—in this case a woollen vest. As a result of the action of the law of increasing return he is able to avail himself of the advantages of large-scale production. His sales department will be in close touch with a number of retailers of woollen goods and in time the raw materials received from Australia via London having been worked up into the finished article, will be dispatched to a retailer in the form of a vest. The various stages through which the wool has passed from the time of its arrival in London to that of its receipt by the retailer in the form of woollen vests have involved many economic factors, notably the granting of credit through the medium of the banking system, the transport of the goods by rail and road and the various stages of production in the factory itself until it is finally handed over to the customer.

EVOLUTION IN INDUSTRY.—The relative importance of the different branches of production varies with the economic development of the country. For instance, in Ancient Britain, the inhabitants were engaged chiefly in hunting, fishing, and lumbering; in the Middle Ages, cattle and sheep-rearing became important, and this was followed by the development of wheat-growing, the importance of which reached a culminating point at the end of the eighteenth century. Since that time manufacturing and commercial occupations have become increasingly important. Such changes are constantly taking place in the life history of most nations.

TEST PAPER

1. Into what three great divisions may the various economic activities of man be grouped?

2. Mention some finished article in which you are interested, and trace it back to the source whence it came as a raw product.

3. Mention the chief stages through which raw wool must pass before it is made into cloth.

4. Distinguish the various classes of labourers required before any article of food, such as tea or sugar, can be brought to the consumer's breakfast table.

5. "The popular distinction of industry into agriculture, manufacture, and commerce . . . fulfils very badly the purposes of a classification." (*J. S. Mill.*)

   Discuss this statement, and give your own classification of industry, explaining the principle on which it is based.

6. It has been suggested that industries should be classified into "primary," "secondary," "tertiary," and so on. Apply this system of classification to the industries of the United Kingdom. Explain the basis of your system.

7. Classify the following occupations—

Butcher, soldier, carrier, tailor, analyst, barber, miner, spinner, weaver, dyer, jockey, bricklayer, dentist, rancher, and cashier.

8. What is the distinction between " manufacturing " and " constructive " industries ?

9. Discuss the difficulties met with in the attempt to classify occupations so that the groups are mutually exclusive. Give the classification which you consider to be the most satisfactory.

10. Discuss the appropriateness of the term " Producer " as applied to a farmer, a miner, an engineer, a doctor, a teacher, and a film actor.

CHAPTER V

The Extractive Industries

The extractive industries are engaged in raising from the soil or obtaining from beneath the earth's surface various forms of wealth. They are essentially local in character, being largely controlled by soil and climatic conditions. The main occupations under this branch of production are hunting, fishing, agriculture, mining and afforestation.

(1) **HUNTING.**—Formerly, hunting played an important part in the industry of the people, since it often formed the means of livelihood for whole nations and tribes. At the present time, however, it is of little importance as a separate calling, and is generally to be found combined with fishing and the production of raw materials of vegetable origin. In a hunting state, manufacture is limited to families which produce for their own use from the raw materials supplied by nature; such as wood, bones, hides, and horn. Hunting is a primitive occupation and along with it there is to be found no class differences such as the antagonism between free-men and slaves. Moreover, very little capital is required, and this usually consists of weapons, tools, and implements. The family income is irregular, being derived from the spoils of the chase and from the abundance of wild fruits, and the transition from abject want to superfluity takes place with great abruptness. As a class, hunters amass little wealth, since their nomadic life renders the collection of stores very difficult.

In hunting, the essential condition for prosperity is the possession of grounds rich in game; but as these can be easily exhausted, a change of settlement is not infrequent and a fight is often necessary before fresh hunting grounds can be procured. Hence among hunting peoples there is a perpetual conflict waged between the different tribes and peoples, which resembles the struggle for existence among the lower animals. In consequence, such a state is characterised by scarcity of population, and concentration in towns is impossible, so that the status and intellectual development of the people remain at the lowest level. Pure hunting races are, nowadays, very few in number, and the time when Britain consisted of

hunting tribes dates back to the times of pre-Roman occupation. When cattle-rearing, agriculture and the exchange of agricultural products begin, a gradual transition takes place from a purely hunting to that of a higher economic state. The question as to whether such transitions are possible and easy depends on the peculiarities of the people and their places of abode, or whether they are in touch with tribes in a higher state of civilisation.

In civilised countries where the population has increased enormously the forests have been reduced, implements for hunting have been improved and in consequence game is much more scanty. Hunting, therefore, finds employment for very few people, and even then only as a by-employment. The profits on the sale of meat, skins, feathers, etc., derived from the chase are small in comparison with the expense of feeding the game. Therefore, in modern civilised countries, hunting is retained merely as a form of recreation and is usually regulated and protected by law.

(2) **FISHING.**—This industry is frequently closely connected with hunting. If it is the main employment of the people, then very rich fishing grounds are required, although they are not so easily exhausted as hunting grounds. With regard to peaceful behaviour and permanence of abode, fishing peoples are superior to those of hunting, and they are generally to be found concentrated in villages and towns where social grades are more noticeable. The fishing operations are conducted by single families and sometimes by the co-operation of a number of families. The outlay and working capital is small, but a certain amount is required. The transition from fishing to agriculture and from fishing to trading takes place easily and often almost imperceptibly. At the present time, peoples engaged exclusively in fishing are to be found concentrated along specially situated coasts or districts, as in the case of the banks of Newfoundland. Among civilised peoples the following types of fishing are to be distinguished—

(1) **Fishing in Open Waters.** This may consist of high sea fisheries which, according to international law, can be conducted free at distances of three miles or more from the coast (although some countries are now claiming territorial rights over much greater margins of sea around their coasts); or coastal fisheries which are to be found along the banks of rivers and seacoasts. Fishing is very important in all countries which are rich in waters, for great stretches of water

may be made to yield as much as similar areas under agriculture. The greatest yields of fish are to be obtained from high sea fisheries, although much capital and considerable risk are involved. Fishing is the best training-ground for shipping, and in many cases, as for instance in the case of Great Britain and Norway, it has been its foundation. The quantity of fish in inland seas and rivers seems to decrease, owing to the growth of traffic and the pollution of the rivers.

(ii) **Fishing in Protected Waters.** This is conducted in ponds where fish are artificially hatched. In many cases good yields are procured on very small areas. The use of fishing waters is under legal restriction, and is confined to certain seasons so as to safeguard the fish at the time of hatching. Further, as to the fish that may be caught, a minimum size is often stipulated.

(3) **AGRICULTURE.**—Agriculture produces raw materials of vegetable and animal origin. The most important products are foodstuffs, which agriculture alone can supply, so that it is regarded as a fundamental industry in any economic system. It employs the greatest number of any calling, and its extension is limited only by the extent and fertility of the soil which is capable of cultivation. Agriculture exercises a great influence on the increase of population and on the development of other branches of production. An increase of population is conditional on the extension of agriculture, and where such extension is no longer possible because the soil is already under cultivation, production can be still further continued by means of intensive cultivation.

Evolution of Agriculture. The two most important branches of agriculture are cattle-rearing and the cultivation of the soil. Cattle-rearing is the older and may constitute the main means of subsistence for a whole people; in this case it is a step in advance of hunting and fishing. As an exclusive means of subsistence, cattle-rearing can be carried on only if the wants of the people are very simple, and if the country is in possession of such a climate that the cultivation of fodder during winter is rendered unnecessary. Under these circumstances cattle-rearing may be carried on as the sole industry without the cultivation of the soil, although it will necessitate a continuous nomadic existence.

With the advent of cattle-rearing, the importance of capital begins to assert itself, since the herds of cattle represent capital, and thus social distinctions are created. Those who have no herds

are obliged to seek a living by rendering services to the owners of the capital, so that there arise the economic distinctions between masters and workmen. Here we have also the sowing of the seed for the formation of States, and the germs of a communal interest. The production of manufactured goods is restricted to the simplest articles and is limited to the members of the family, whilst trade has not developed beyond the stage of simple barter. Any rapid increase of population is restricted by the yield of the pastures, so that no great concentration takes place. In consequence of the nomadic life of the people, their dwellings are of the rudest kind, and the whole of their property is of a movable nature. Such people may remain in the same stage of civilisation for a very long period.

Along with cattle-rearing we find the beginnings of the cultivation of the soil, small patches being cultivated at first with such plants as can quickly be harvested. Finding by experience that the combination of cattle-rearing with the cultivation of the soil is more profitable, the population gradually realise the advantage of settling permanently in the same place, and so become an agricultural people. This development, which may also arise out of hunting and fishing, is a great step in industrial progress. Production becomes more independent of nature, and economic considerations lead to an increase in the products of the soil. The laws of utility are made to supersede the free operations of nature, so that by cultivating the soil in a better manner it is possible to feed a larger number of people from the same area. Human wants tend to become more varied and are satisfied by regular and peaceful work.

When permanent settlement is assured, the people begin to erect more substantial dwellings, which give a higher standard of comfort. Step by step communities are formed and order is established, and among the people living together as neighbours there grows up a permanent bond of interest which slowly develops into a State. Interest in the soil forms a basis for the ownership of land, the legal conditions and stipulations differing among different peoples. At first the land system is based on communal ownership, together with certain individual rights of use for the members of the community. Later on portions of such property pass into the hands of individuals and are privately owned.

A permanent abode leads to a feeling of home life and to a sense

of common interest. With the beginning of agricultural life, large gaps exist between the different settlements which are used solely for hunting or for cattle-rearing. With the increase of population larger areas are brought under the plough: at first, the more fertile lands, and then the less fertile, being cultivated.

The demand for manufactured articles is met by the agricultural people themselves, who produce articles of a similar kind, and out of this there gradually develop separate manufacturing industries.

ECONOMIC FACTORS.—Land. Since agriculture is so largely dependent on the nature of the soil, land is the most important factor for the successful conduct of that industry. The soil feeds and nourishes plants and animals, and on its fertility depends its productive potentiality. In case the yield becomes diminished, however, it may often be restored by the application of fertilisers. In addition to the extent and fertility of the soil, climate plays an important part, although this can be little influenced by human foresight and labour.

Labour. Next to land, labour is the most important agent in agricultural production. The further agriculture progresses, the greater are the efforts which are made to guide the productive powers of the soil, and to maintain their fertility. The most necessary work in agriculture is of a simple kind and can easily be adapted to natural and seasonal changes. The agricultural labourer has, therefore, to change his work with the seasons, so that an extensive division of labour is rendered impossible. Agricultural work is more healthy than that of most other callings, and the physical and mental activity involved in its conduct prevents the workers from becoming over-specialised or one-sided.

Capital. With the increased development of agriculture, capital takes a more and more important place. In addition to buildings, the *fixed capital* also includes machinery and implements, the rolling stock, and animals used for breeding purposes. Among the items of working capital are food-stuffs, corn for breeding purposes, corn for seeds, fertilisers, etc.

Organisation. The method of organisation is dependent on the soil and climate, on the available supply of labour, and on the conditions of sale. In the first place, soil and climate have to determine whether the main basis of the business shall be the cultivation of the soil or the rearing of cattle, whilst the conditions

of sale determine the proportion of the different factors engaged in production. In this respect, the difference of extensive and intensive agriculture is of importance. If a large area of land is cultivated very lightly and without much preparation or expenditure, cultivation is said to be extensive, whereas intensive cultivation is the thorough and careful treatment usually of a small area. In extensive agriculture the capital is of less importance, the production being left chiefly to the free operation of nature. Great stretches of land are worked with comparatively little labour and practically are not fertilised at all. After the harvest, the land is allowed to remain fallow in order that it may recover. Extensive cultivation is necessary where the population is small, manufactures undeveloped, trade inconsiderable, and the demand for the products of the soil very limited. Under such circumstances, natural economy often prevails, the individual farmer producing only what is required by his own household.

In intensive cultivation, however, capital and labour are so applied to the soil as to produce the largest possible yield. The soil is carefully drained or watered, as the case may be, and fertilisers are freely used to render the area more productive. This system is only possible, however, where there is a great demand for agricultural products, and exists chiefly in progressive states of civilisation, and especially in the neighbourhood of towns.

Small Holdings. A distinction must be made between small, medium, and large holdings, although it is impossible to draw a clear line of demarcation. Very small holdings do not employ any ploughing team, whereas the medium holding would employ one or two, although, as in the small holding, the farmer will assist personally in the manual work. In the case of large holdings, one or more managers may assist in the direction of the whole concern.

Small holdings possess the advantage that the farmer can devote his attention to such marketable vegetables and plants as require much diligence and careful treatment of the soil. If the land is divided into small holdings, larger gross and net yields may be obtained from the same area than if it were worked on the system of large holdings. The holding of the small farmer is continuously under his own eyes, and he can employ his wife and children to assist in the work, so that he is not dependent on outside labourers.

Sometimes, however, the small holdings fail to offer sufficient scope for the abilities of the farmer, and the advantages of division of labour and the utilisation of the best machinery are absent. Further, in the case of a bad harvest, the whole undertaking is endangered.

Such small farming is most successfully carried on in the vicinity of towns where such products as garden plants, milk, dairy products, fruits, etc., can be easily marketed.

The prospects of the small farmer are more secure when access can be had to profitable by-employment in times of agricultural depression: but where such opportunities do not exist, small farming is a very risky enterprise on which to embark.

Large Holdings. Farming on a large scale has the advantages of comparatively small working expenses, a better division of labour, the employment of superior machinery, and the possibility of extensive improvements in the soil by means of irrigation or drainage, and other technical improvements. Such advantages, however, are only possible where capital, intelligence, and diligence are sufficient. The disadvantage of large-scale farming is the great social cleavage which is usually created among the agricultural population. The establishment of large holdings leads to the disappearance of the independent yeoman class which is often replaced by a rustic labouring proletariat. The value of the gross and net yields of large holdings is comparatively small, owing to the fact that the land cannot be exploited to the same extent as with small holdings.

Medium Holdings. The medium-sized holdings come between the above-named extremes, and these also have their advantages and disadvantages. The ideal seems to be that these farms should predominate and that the small farms should only extend where they are justified from an economic standpoint, and large holdings should be developed to such an extent as will allow for technical progress to be made.

(4) AFFORESTATION.—Object. The cultivation of forests has for its object the supply of timber for household purposes, for building and manufacturing, and the preservation of forest areas which are of importance in regulating the climate and the flow of the rivers. The significance of afforestation in the national economy is seen in the large number of products which result therefrom, and also in

rendering useful large stretches of land which would otherwise be of little or no value.

Factors of Production. Land is by far the most important factor in afforestation, whereas the part played by labour is comparatively unimportant.

In afforestation the capital consists of the forests themselves and the character of their timber. Under the powerful influence of nature, this considerable capital value gradually reproduces itself with the employment of a very small amount of labour. A characteristic feature of this branch of industry is its failure to succeed if undertaken on a small scale; therefore it must be carried out over a large area, so that it is more suitable for State or municipal enterprise.

Administration. If it is intended to carry on the production of timber continuously without a decrease of the capital value of the forests, it is important that the amount cut should not exceed the annual increase of the timber. Hence it is necessary that a careful estimate should be made with regard to the existing timber reserves and the annual rate of growth of the timber. The rate of growth in cubic measurement as well as in timber value differs with the various kinds of wood, since it depends on the species of the timber as well as on the nature of the soil.

Forms of Exploitation. The methods of exploitation may be classified as follows—

(1) The exploitation of *high forests* in which the trees are permitted to grow as tall as possible, and are cut down only after a long period of time.

(2) The exploitation of *low forests* in which the natural growth of the trees is interrupted by the removal of parts of the trees for special purposes.

(3) The exploitation of *medium forests* in which low trees are grown alongside tall ones.

In some cases the quantity of timber grown on a certain area is the important consideration, whilst in others it is the value of the timber.

The Yield of Timber. The yield consists, in the first place, of the increase which has occurred in the forest itself, together with the amount of timber collected in making roads through the forest; and in the second place, in the production of by-products, such as

resin, grass, etc. An important point in afforestation is the existence of good transport facilities. With regard to the maintenance of the yield the following policy should be adopted—

(*a*) A certain area should be set aside by the State for the purpose of afforestation, and efficient managers should be appointed to carry on the work.

(*b*) If necessary, assistance should be given by the State to municipalities for the conduct of afforestation.

(*c*) Legal protection should be offered to prevent wilful damage to forests.

In most civilised countries replanting is rendered obligatory on all persons engaged in removing the trees.

(5) MINING.—Natural Conditions. Mining is more dependent on nature than any other branch of industry. Nature is the determining factor, for mining is impossible if there are no natural mineral resources. Hence this branch of production is usually strictly localised and the minerals when once removed cannot again be replaced. In the distribution of mineral deposits over the earth's surface, nature has been very fickle so that the results of the working in different areas vary considerably.

Labour. Mining is one of the most arduous occupations, and is at the same time subject to peculiar dangers. In this calling the labourer has little, if any, prospect of becoming his own master, and must, therefore, work for a wage. The workmen generally live in the vicinity of the mines, since they expect to be permanently engaged in mining work, and it rarely happens that there is any great influx of labourers from other callings. If the mines are prosperous, the wages may be high, but if depression sets in, it is difficult for the miners to find other kinds of work. Owing to the fact that the workers are almost exclusively dependent on mining, a state of trade depression often causes great hardship in mining districts. It is for this reason that in recent years light industries have been encouraged to settle in mining districts where deposits are nearing exhaustion.

Capital. Fixed capital plays a very important part in mining and assumes the form of shafts, galleries, machinery, etc., which cannot be removed without considerable loss.

Output. Mining differs very greatly from most other industrial enterprises by its entire dependence on nature for the result of its

working and the extent of its deposits, for these can be altered neither by the progress in technique nor by the investment of capital.

The duration of the economic working period of mines varies considerably. Tin mines, for instance, in some places have been worked for hundreds of years, whereas oil wells are generally exhausted in from two to ten years. In the case of coal, it frequently happens that mines have to be closed because they are incapable of withstanding the competition of richer deposits, and the considerable capital invested in the mines does not at first yield any interest and is lost entirely if there is no prospect of further yields.

TEST PAPER

1. Enumerate the main branches of the Extractive industries.
2. Say what you know of hunting as an occupation, and mention the branch of production to which it is most closely allied.
3. What are the essential conditions for the success of "hunting" and "fishing"?
4. Why is "agriculture" regarded as a fundamental industry in any economic system?
5. Trace the evolution of agriculture.
6. What are the most important requisites for the successful conduct of the agricultural industry?
7. Compare the relative advantages of small, medium, and large holdings.
8. Enumerate the most important factors in afforestation. Why does the State usually undertake this branch of production?
9. Examine the economic characteristics of the mining industries.
10. "Mining is more dependent on Nature than any other branch of industry." Explain this statement.
11. Why are mining concerns less suitable than agricultural undertakings for ownership by a single person?

CHAPTER VI

Manufacturing and Constructive Industries

NATURE AND DEFINITION.—The second great branch of industry, is the manufacturing and constructive industry. Manufacturing industries are those which are engaged in working up raw materials with the object of producing from them goods of a higher value, by processes of separation, combination, or of transformation.

Historically, the manufacturing industry is younger than that of extraction. It started in the production at home of articles for the use of the family itself, and gradually, with the recognition of the advantages of division of labour, special callings were established, and became more and more numerous. From the economic standpoint, manufacturing industries are very important, because they aim at increasing the value and variety of the nation's products; and by causing a concentration of population to take place in towns, they bring about many social inducements, and a stimulation of intellectual life. They also exercise a favourable effect on the extractive industries by creating a demand for further products and in supplying them with tools, machinery, etc. Further, they stimulate international trade, which leads to a higher standard of comfort and intellectual intercourse among the nations.

The development of manufacturing industries along with the production of raw materials is a natural step in the progress of division of labour. The extent of manufacturing in comparison with other branches of production, varies considerably in different countries, as well as in different parts of the same country.

Manufacturing is intimately connected with the production of raw materials, because it is engaged in working up the raw products, and the workers in the manufacturing industries are fed by the food-stuffs derived from the extractive industries.

Moreover, the market for manufactured goods is found, to a great extent, among the producers of raw materials at home. Of course, with the development of a more highly specialised system of manufactures, it happens more and more frequently that the home manufacturers have to rely on imports of raw materials from abroad, where they also find important markets for their finished

goods. With the rapid development of commercial intercourse during the nineteenth century, the manufacturing industries have made great strides, population has increased, and international division of labour has led to the exchange on a large scale of manufactured products for the raw materials and food-stuffs of foreign countries.

CHARACTERISTICS OF MODERN MANUFACTURES.—The manufacturing industry of the Middle Ages differs so considerably from that of the present time that the transition from one to the other has been called the "Industrial Revolution." That "revolution" was characterised by great alterations in production, in the method of transport, and in the conditions of sale. With the introduction of machinery, production became concerned with the output of masses of goods and not merely of separate articles. The chief inventions which paved the way to such large-scale production did away more and more with the necessity for monotonous and arduous toil, which were inseparable from the use of hand labour. The production of huge masses of articles brought with it the need for sale in large quantities, which was facilitated by the improvements in the means of transport, by the abolition of restrictions on personal liberty, and by the better feeling prevailing among the nations, all of which helped to transform the entire globe into a great area consuming the products from its different parts.

Since the "Industrial Revolution" developments of techniques of production, increased mechanisation, improved communications and means of transportation have continued to bring about greater volume of output and greater variety of goods (the luxuries of one generation becoming the necessities of the next), and at the present moment this evolution has again reached a tempo which has led some people to talk of another industrial and commercial "revolution."

Many industries were first sited at the place of occurrence of the raw material which they used or the coal which was their motive power. It is for this reason that industry developed rapidly in the Midlands and the North of England. During this century there has been a considerable spread of industry in the South of England and outwards from the coal-fields and mineral deposit areas. The much greater use of electricity as a source of power and our greater dependence on imported raw materials have helped to encourage this movement of industry towards ports or marketing centres.

It has also been deliberate Government policy to diversify industries in areas of the country which were too dependent upon a particular industry. There have been a number of cases where an industry having slumped, or a coal-field or mineral deposit having been worked out, a whole area has been subjected to widespread unemployment and depression, and it is for this reason that the Government has provided trading estates and other inducements to new industries to infiltrate into excessively specialised areas in order to give variety of employment and activity to the area. This tendency has recently received new importance in the strategic disadvantages of over-concentration of important industries in wartime and in the need to reduce the continual spread of Greater London and other large conurbations which have brought about concentrations of road transport far beyond that which the road systems can carry, and social problems of health and housing.

ESSENTIALS OF SUCCESSFUL MANUFACTURE.—The manufacturing industry of a nation, as a whole, as well as of each separate branch, is dependent for its prosperity on certain essentials. These essential conditions are partly natural and partly historical, although it is often possible to make them more favourable by human assistance. The relative importance of these different conditions varies at different periods, so that their influence is reflected on the existing state of industry. Every *entrepreneur* must know these conditions and influences as far as they affect his particular line of business. The main essentials of successful manufacture are to be found in the adequate provision and efficient control of the following factors—

1. Raw Materials;
2. Labour;
3. Capital;
4. Conditions of Sale.

Raw Materials. An essential condition for the success of a manufacturing concern is the possession of abundant supplies of raw material. Under the domestic system, where the work is limited to the family, the raw matèrials, which are of a simple kind, are procured from the immediate vicinity. With the development of economic life, there takes place a separation between the production of raw materials and that of manufactures, so that some branches of manufacture are removed to places of consumption, whereas others remain in such places as are within easy reach of the

raw materials. For instance, those manufactures are naturally to be situated in proximity to the raw materials, in which the raw product plays a specially important part as compared with labour and capital, or in which the raw materials are heavy and require large expenses of transport. Again, the treatment of ordinary metals is for the same reasons restricted to the neighbourhood of the ore and the coal-mines. In the case of better-class castings, the manufacture of machinery and the later stages of production, the works may be situated at a greater distance from the source of raw materials, since their value will stand the cost of transport.

The more developed a manufacturing concern becomes, the more easily will it flourish independently of the local supplies of raw material. The foundation of a manufacturing industry may have been due originally to the existence of large supplies of raw material, but its continuance in that particular district may be due to other reasons. For instance, in the course of time a considerable amount of capital may have been invested in the form of buildings, technical appliances, the acquirement of a large circle of customers, and the consequent increase of goodwill; and these may turn out to be more important than the former advantage of the possession of an abundance of raw materials.

Those branches of manufacture which are engaged in the working up of raw materials from abroad are often conducted more successfully in the neighbourhood of large seaports, where the raw material can be bought by the manufacturer himself, thus saving the agent's commissions and at the same time affording him a greater variety of choice and more frequent opportunities of profiting by low prices (e.g. by the purchase of raw materials which have been partly damaged). For this reason, sugar refineries have been established at Bristol and London, as well as at Hamburg, Bordeaux, and Marseilles. Other examples are the tobacco factories at Bristol, as well as cotton-spinning in the neighbourhood of Liverpool and Glasgow, these ports being very favourably situated for the import of raw materials from the United States.

Further, a business conducted under these circumstances has the advantages of comparatively small expenses of transport with regard to the waste products, for these would be heavy if such raw materials had to be sent long distances. Many waste materials, resulting from the consumption of a large population, are supplied by the great

cities, where there is a variety of skilled labourers and a large supply of capital.

The treatment of various metals, because of their luxurious nature, is carried on mainly in the great cities, where there is a demand for artistic and tasteful work. For the same reason, musical, scientific, and other instruments, as well as fine machinery, are usually manufactured in large cities.

Labour. One of the main points in manufactures is that there should be sufficient labour available for the different requirements which have to be taken into consideration. It is to the interest of the entrepreneurs, as well as to the workpeople, that labour should be efficient, skilful, and reliable. In the price to be paid for labour, however, the interests of the entrepreneurs and those of the workers come into conflict.

The labour engaged in manufacturing differs from that of the extractive and commercial callings in some respects. In the extractive industries, the work consists in loosening the material resources of Nature from their natural positions, as in the case of mining, or the mere direction of natural forces into channels whereby new materials may be produced, as in the case of agriculture and afforestation.

Natural forces or powers are also used in manufactures ; but in this case they are so completely controlled that their result can be calculated exactly, whereas in the extractive industries the output is largely dependent on the fickleness of Nature. The most scientific agriculturist cannot foresee the state of the weather for the coming year, and the most careful planning of forests cannot prevent the occurrence of storms. Since manufacture is not dependent on Nature to such an extent as are the extractive industries, a more independent line of development can often be followed. Manufacturers are not bound to any particular spot, for, unlike agriculturalists, they are not dependent on the nature of the soil. The emancipation of manufactures from a particular spot, however, does not obviate the necessity for the choice of the most favourable conditions. The possibility of the establishment of an extensive division of labour dependent on local conditions is important in this respect. Again, manufactures are not so restricted in the disposal of time or by the change of seasons as in the case of the extractive occupations.

Agriculture and afforestation have to be planned according to the rotation of the seasons, but, with certain exceptions, this is not the case with regard to manufactures.

Capital. One of the most important conditions of successful manufacture is the existence of adequate supplies of capital and willingness to invest in industry. The capital required may also be obtained by means of credit, but this is exceptional, except where the investors are guaranteed against all risks and where there is a likelihood of a profitable continuation of the enterprise to which they grant their loans.

Districts with a sparse population have frequently an insufficient number of workers and inadequate capital for the successful carrying on of manufactures, and are, therefore, hesitant in embarking on such enterprises. Where the climate is suitable, opportunities are frequently afforded for the production of raw materials, and this is more in accordance with the existing economic conditions than an industry which is stimulated solely by artificial means. If good means of transport are available, the conveyance of raw materials to places abroad will naturally lead to an increase of capital. Manufactured products are often more profitably imported from abroad until the time arrives when, with the saving of capital, the increase of population, and progress in technique, those branches of industry which are most in accord with local conditions, will begin to flourish and gradually supplant the demand for the imported goods.

Conditions of Sale. Ready access to markets, home or foreign, helps to determine the size of industries and localises them. The markets for complex manufactured articles are limited to the more progressive areas so that industries producing such articles tend to be located near the main markets where facilities for selling them exist. Manufacturing industries also require extensive transport facilities both for the raw materials which they employ and for the disposal of their finished products. Hence industries tend to grow where these facilities exist and transport costs are reasonable. If a manufacturing concern is to be established, a place of business should be chosen which is in the neighbourhood of such places as offer good opportunities of sale. Manufacturers of fine articles involving artistic design are more favourably conducted in the great centres of consumption. Country people desiring fancy goods prefer

to make their purchases in the large towns, where a greater choice is to be obtained, and hence there is a tendency for the production of such articles to be located there. The manufacture of fancy goods is not carried on to any great extent in the small towns, and the same difference which exists between the town and the country and between large and small towns is also found to exist between the various parts of a great city. Shops for the sale of fine articles are usually to be found in the most fashionable streets, in the vicinity of the social centre, the theatres, and the large hotels, e.g. the West End of London. The shops for the sale of other manufactured articles are, for practical purposes, situated in the neighbourhood of the commercial or manufacturing quarters or in the suburbs. The rent of the shops situated in the fashionable quarters cannot easily be borne by articles of ordinary consumption, and, moreover, the demand for such articles is not so great there as elsewhere.

Other Factors.—From the foregoing it will be seen that the factors determining the success of modern manufactures are numerous and complex, since account must be taken of a great variety of natural factors—physical, geological, and climatic. Of equal importance are the economic and psychological factors. The latter may take the form of governmental or municipal "protection" of an industry in a particular locality, e.g. the special attempts made in medieval times to foster the cloth industry, or the modern regulative system of protective tariffs. This complex of factors may give an industry a momentum which carries it forward after the original forces have grown weaker or even disappeared, with the result that after a district has had a long start it may go on growing at the expense of other districts which, under the conditions of later years, might have proved at least as attractive if a new start had been possible.

TEST PAPER

1. Explain the function of manufacture.
2. What, in your opinion, are the leading characteristics of modern manufacture?
3. Explain how manufacturing occupations differ from constructive occupations, and give three examples of each type.
4. State the chief requisites of successful manufacture.
5. Contrast the manufacturing with the extractive industries.
6. What have been the effects of Capital and Division of Labour upon the development of modern manufactures?

CHAPTER VII

ORGANISATION OF A MANUFACTURING BUSINESS

MANUFACTURING industry covers such a wide field of products and sizes and types of business that it would be useless to outline a form of organisation common to all, although certain essential activities and services can be indicated.

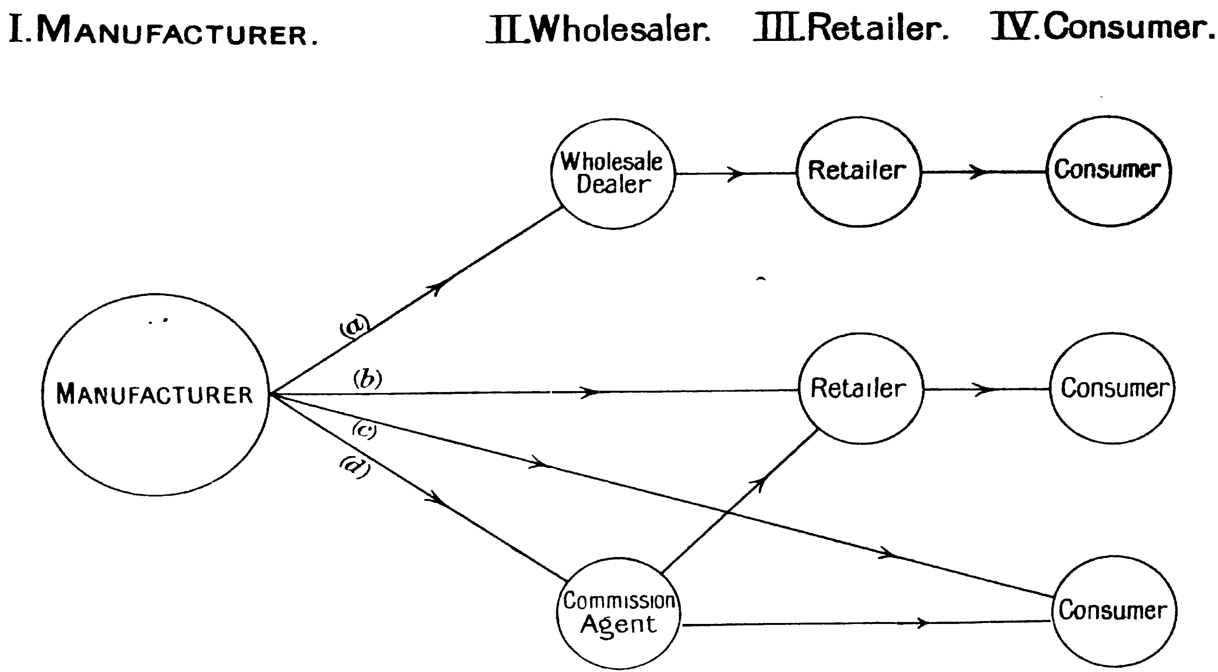
First the raw materials or semi-manufactured goods which form the basis of its production must be bought and stocks carefully checked and maintained at suitable levels, with adequate control of issues to the factory.

All the technical functions of planning production, the types and quantities of machinery and plant which can be productively employed, the design of the product, the flow of work through the various processes without undue short time or overtime working, the inspection of output, the planning and progressing of contracts must be controlled by the appropriate technical experts.

The incidence of costs must be very carefully watched in modern conditions of competitive production and sale, and the Accounting staffs will be required to keep financial accounts to show overall expenses, revenues and profits and the relative assets and liabilities of the business at any given moment. They will also be required to trace costs through to individual products or processes by means of cost accounting techniques and by frequently comparing actual with anticipated costs and pinpointing as quickly as possible any divergencies which occur. They are now also frequently called upon to project their expense and revenue allocations forward by the use of budgetary control to forecast the profits, production targets and costs upon which the activities of the business will be pre-planned.

Disposal of the finished products will be the concern of the Sales staff who through their representatives in the various markets must keep a careful eye on market trends, estimate future sales, dispose of current products and report back to Management all marketing information and research which may have an effect on future production plans. They will also be responsible for advertising and propaganda designed to increase or maintain their markets.

MANUFACTURER'S CHANNELS OF DISTRIBUTION IN THE HOME TRADE



The break between the mass of goods coming from the factory and their division into many small streams through which they are sold may involve warehousing, packing and transportation functions by another section of the organisation.

Then there are the commercial functions involved in obtaining the company's capital, making its contracts, arranging credit terms and finance, negotiations with trade unions and trade associations, and the conduct of its correspondence and office routines.

Personnel matters are often now the subject of a special department or officer. Staffs must be hired and dismissed, staff records kept, pension funds arranged, welfare facilities provided and looked after. As businesses have tended to increase in size, this function has developed rapidly to combat the impersonal nature of the large business and to maintain a firm's competitive powers in a difficult labour market position brought about by full employment.

These functions all call for specialists in technical and commercial matters, and the function of the management of an industrial organisation is to co-ordinate the work of these specialists in the interests of the most efficient conduct of the business as a whole, and to take the responsibility for deciding upon general policy and for seeing that that policy is implemented.

There is a wide range in size of manufacturing businesses, and in the smaller business proprietors or managers may have responsibility for a number of the functions mentioned above. As the size of the business increases, more and more specialists will be brought in, and the areas of their responsibility will be reduced or more closely defined. It may then be necessary to have several levels of management co-ordinating certain functions and reporting up to top management who may be men of wide experience and proved business acumen but who may not have an intimate knowledge of any of the specialist functions being carried on within the business they control.

DISTRIBUTION OF MANUFACTURED GOODS.—The distribution of the goods of a manufacturing business will now be considered in so far as it relates to the home trade, whilst that of the export of manufactures will be dealt with later. Of recent years, many manufacturers have assumed the functions of the various intermediaries and sell their product directly to the actual consumers.

There are various channels which may be chosen by the manufacturer in the distribution of his output, the chief of which are shown on the diagram on page 54. He may sell—

(*a*) Directly to the wholesaler, who organises the market and distributes the goods to the retailer.

(*b*) Directly to the retailer. There is a growing tendency for manufacturers of boots, shoes, hats, etc., to distribute them through their own retail stores.

(*c*) Directly to the consumer. This is often done where the market for goods is a narrow and well-defined one and goods are often manufactured to direct order. It may also happen where much after-sales servicing of the product is necessary or where mail-order business has been developed.

(*d*) Directly to a Commission Agent, who either distributes through the retailer or sells directly to the consumer. Many goods such as pianos, typewriters, sewing machines, agricultural implements, and motor-cars are especially adapted to this method.

(*e*) Direct through a selling association. Since the war many manufacturing undertakings have combined into co-operative selling associations, usually under the leadership of a large firm. The object of this method of organisation is to procure a uniform export policy amongst the various manufacturers who enter the association. Such selling associations often devote themselves at first to the home market, but, subsequently, they extend their operations to foreign countries, where they are able to establish a firm footing by the founding of their own branches.

The choice of methods will depend largely upon the kind of commodity produced and the nature of the demand for it. It is very seldom the case, however, that a manufacturer adopts any one of these methods to the exclusion of all the others, but all the methods are usually in operation concurrently.

TEST PAPER

1. Into what departments may the organisation of a manufacturing concern be divided?
2. Explain the need for a proper system of correlation between the various departments of a manufacturing concern.
3. Discuss the chief methods adopted by the manufacturer in the distribution of his finished products.
4. Elucidate, with illustrations, the reasons why particular industries become and remain localised in particular districts or countries.

5. Trace the effect of the adoption of mechanical methods and of the growth of large-scale operations in any one branch of industry.

6. Sketch the organisation of a staple industry, such as the cotton industry, indicating the links in the chain of production and distribution from the growing of the raw materials to the selling of the finished goods in the shop.

7. Using for the purpose of illustration some manufacturing industry with which you are familiar, explain the business machinery that has been developed for the purchase of its raw materials and for the sale of the goods it manufactures.

8. Describe carefully the organisation of any manufacturing business with which you are acquainted under the following headings—

(*a*) The division into departments.

(*b*) The delegation of duties among the members of the staff.

(*c*) The function of the business in relation to the outside world.

9. "Efficient organisation is the basis of successful enterprise." Discuss this statement and show how you would organise the commercial side of a large manufacturing business, indicating the chief functions of the various departments.

10. Why have the functions of personnel management increased in importance with the growth in the size of business organisations?

CHAPTER VIII

INDUSTRY IN GREAT BRITAIN

FOR more than one hundred years Great Britain was the most important manufacturing and commercial country in the world, although its predominance in this respect has now been superseded by the United States of America. This industrial prosperity is due in no small measure to natural advantages. On account of its situation as the centre of the land hemisphere, and midway between the civilised States of Europe and America, Great Britain may be said to hold a most favourable position in relation to the world's commerce. The country is highly favoured by its sea-board, estuaries, and harbours, its soil and climate, with their respective variations, and its mineral resources. The coast-line is much indented with numerous bays and river mouths, stretching far into the interior, combined with a remarkable river and canal system which facilitates industry in a high degree. Harbours are scattered along the coast and near to the estuaries, and render great assistance to ship-building and the conduct of sea-borne trade, whilst the shallowness of the surrounding seas has given rise to valuable fisheries. The physical features consist partly of flat, fertile land, as in the South-east of England, and partly of highland, as in the West and North-west of England and in Scotland, where the chief mineral deposits are to be found. Further, the constituents of the soil and the moist, equable climate are by no means the least important factors in determining the industrial prosperity of the country, for they are favourable to the fertility in plant life and to the vigorous growth of animal life. In addition to these great natural advantages, the power and civilisation of Great Britain are also dependent upon the peculiar physical and mental characteristics of its people, which are marked by their practicality, their desire for enterprise, their coolness and perseverance.

The concentration of the population of England is higher than that of any other European country, except Belgium and Holland, it being found chiefly in towns; whilst in Scotland and Ireland there is only a medium density.

CLASSIFICATION OF BRITISH OCCUPATIONS.—In accordance with the basis of classification, as explained in an earlier chapter, the occupation of the people of Great Britain may be divided into the following categories—

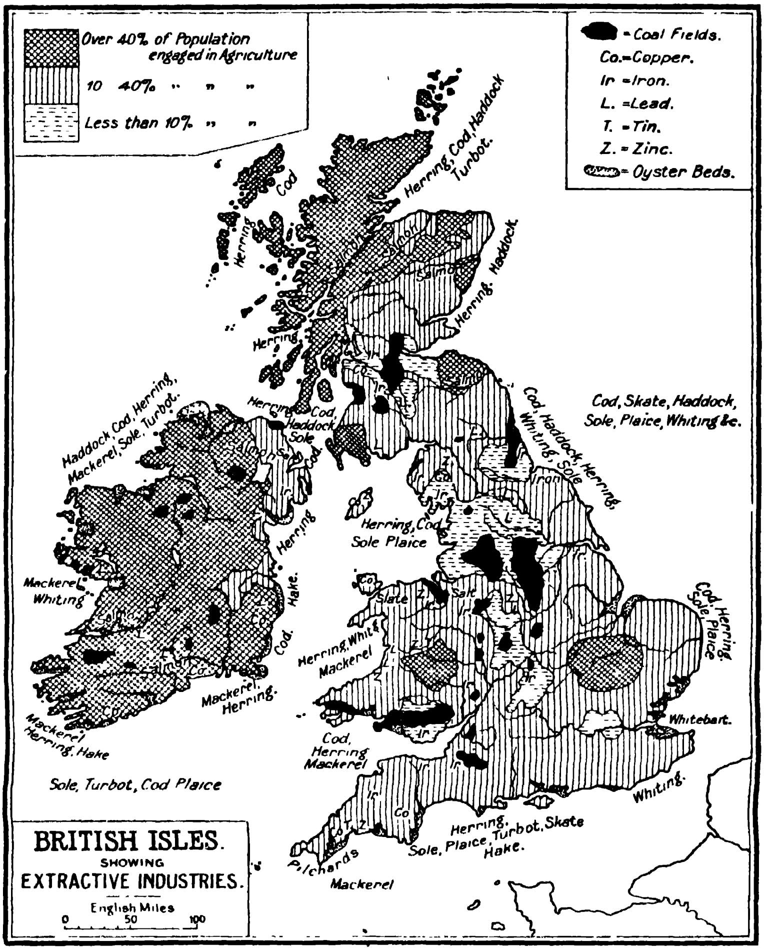
(1) Extractive industry.
(2) Manufacturing and Constructive industry.
(3) Commercial activities.
(4) Direct Services.

In consequence of the great urbanisation of the population, the extractive are less important than the manufacturing industries. About 8 per cent of the persons employed in the country are engaged in extractive occupations; a little over 50 per cent in manufacturing and constructive industry; and nearly 25 per cent in commerce.

Extractive. For the purposes of *agriculture*, the land of Great Britain is divided into a number of large estates, which are usually split up into smallholdings and leased out by their owners to tenants, who pay a stipulated rent in return for their holding. This is known as tenant-farming, and differs from that of some Continental countries in that there is a complete absence of independent peasants owning their own holdings. The method of cultivation which mostly prevails is that of the intensive system, although the actual area under tillage represents but a small portion, the land being used for more profitable purposes.

Afforestation is almost insignificant, only about 6 per cent of the area being covered with forests (which are located chiefly in Scotland), whilst *pastures* and *meadows* cover about 54 per cent of the entire country. Of great importance, also, is the yield of fish—notably that of herring off the East Coast, near Yarmouth; and near Wick, in the northern part of Scotland; cod is caught off the Dogger Bank; the oyster fishery is restricted chiefly to the mouth of the Thames; whilst whale fishery is conducted from Dundee.

The existence of large quantities of *minerals* has led to the establishment of extensive *mining* operations. Copper, tin, lead, manganese, china clay, and other minerals are found in various parts; but the deposits of coal and iron have been the mainsprings of industrial prosperity. The application of these two minerals to the manufacture of all kinds of machinery, of which British people were the



BRITISH ISLES.
SHOWING
EXTRACTIVE INDUSTRIES.

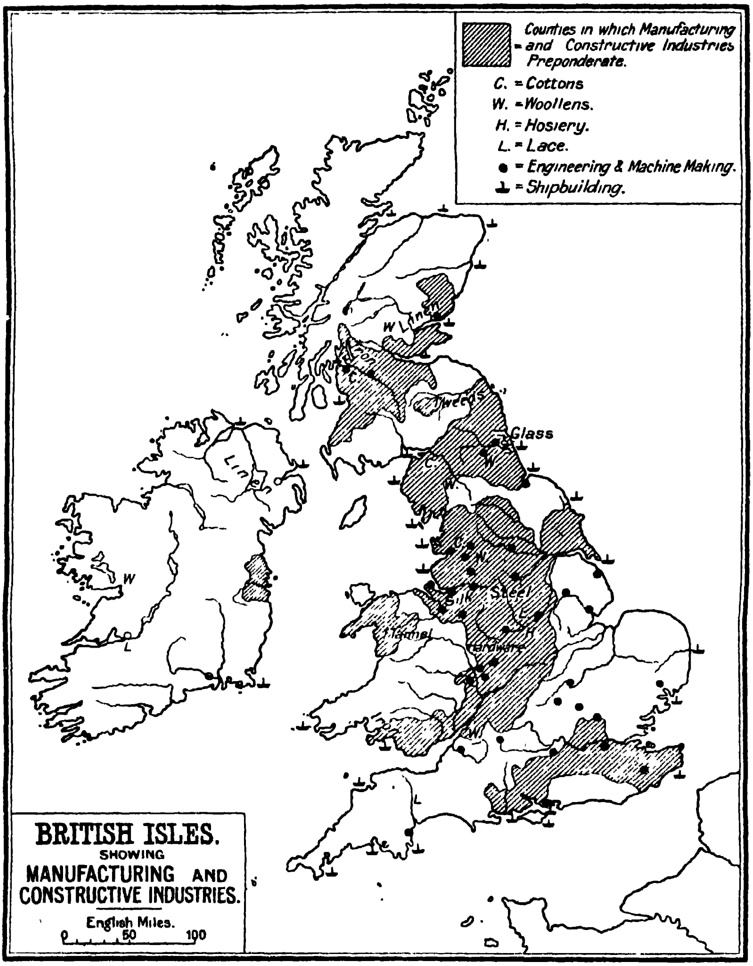
inventors, gave to this country the start of other nations, and placed her in the vanguard of industrial activity. The iron and coal in Great Britain are generally found in proximity to each other—a fact which adds greatly to the facility of working the mines and of turning their resources to practical account.

The chief areas of coal-mining are situated in the neighbourhood of Whitehaven, Newcastle, Shields, Sunderland, Manchester, Sheffield, Birmingham, South Wales, and Bristol; the principal iron-producing areas are the same districts, or in close proximity thereto, as well as the Furness district of Lancashire and the Cleveland district of Yorkshire.

A considerable proportion of the iron ore used by British industry now has to be imported.

Manufacturing and Constructive. The manufactures of Great Britain are the oldest of the modern large-scale industries, and, owing to the abundance of suitable raw materials, the early introduction of industrial freedom, the inherent capacities of the people, the favourable position of the country with regard to exchange, and a series of other fortunate circumstances, the country was soon enabled to establish itself as the leading manufacturing nation of the world.

The most important manufacturing region is that of a line passing through the towns of Manchester, Birmingham, Leeds, and Sheffield. One of the chief branches of manufacture is that of textiles. The centres of the cotton manufacture are Manchester, Blackburn, Preston, Glasgow, Belfast, etc.; the woollen industry is centred in Leeds, Bradford, Halifax, Huddersfield, Glasgow, etc.; the linen industry is specially located in Ireland (with its centre in Belfast), in Dundee, Forfar, Barnsley, Leeds, Liverpool, etc.; the silk industry in Cheshire, Lancashire, Yorkshire, London, etc.; lace-making and hosiery-making in Nottingham, Leicester, etc.; carpet-making in Kidderminster, Wilton, etc. Another large section of industry is engaged in the manufacture of *iron*, *steel*, and *metal goods*, the construction of *tools* and *machinery*, which is carried on mainly in the vicinity of the coal-fields, or near to the iron-smelting centres. The principal areas of production are in the neighbourhood of Birmingham, Sheffield, Wolverhampton, Newcastle, London, Glasgow, etc. Other manufacturing and constructive occupations of great importance are ship-building, with its allied branches, at Newcastle,


Counties in which Manufacturing and Constructive Industries Preponderate.
C. = Cottons
W. = Woollens.
H. = Hosiery.
L. = Lace.
● = Engineering & Machine Making.
⊥ = Shipbuilding.
Linen
Tweeds
Glass
Steel
Silk
Flannel
Hardware
BRITISH ISLES.
SHOWING
MANUFACTURING AND
CONSTRUCTIVE INDUSTRIES.
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0 50 100

Shields, Glasgow, Greenock, London, Liverpool, Hull, etc.; pottery in the Pottery District, with its centre at Stoke-upon-Trent; paper and leather, chemicals, clothing (with its centre in London), brewing, confectionery, and employment connected with the preparation of food and luxuries.

Commercial. The commercial activities of Great Britain have always been of the greatest importance. A considerable volume of commodity imports is obtained from all parts of the world, notably in the form of raw material and foodstuffs. Since the second World War, exports have taken the form of ships, textiles, machinery, transport equipment and a wide range of manufactured products. In respect of this commodity trade, however, Great Britain has long had an "adverse" balance, where imports exceed exports.

Commodity trade is, however, only one form of commercial activity and the country enjoys an important source of income from the performance of services. Prior to the depression of 1931, this was sufficient to pay for the surplus imports and leave a balance in our favour. During the second World War most of these sources of income from overseas were lost and are only now being slowly rebuilt. As a result, a considerable external debt has been created, and the home market has been deprived of goods which have been channelled into the export market to keep this debt to reasonable proportions. The principal items of revenue from services—the so-called "invisible items"—are as follows—

1. *The Amount Due for Freight.* Even though the British mercantile marine has fallen in relative importance as compared with the merchant shipping of other countries, a substantial net revenue is derived from freight payments. In 1958 the net income received from this source was about £165 million.

2. *Income from Overseas Investments.* Long years of profitable trading abroad gave the people of Great Britain substantial sums to invest in overseas countries. These investments took the form of loans to foreign governments and municipalities as well as investments in the shares and debentures of all kinds of trading concerns. In 1958 the interest and dividend payments yielded a net income of about £55 million. The second World War caused a considerable decline in the income from this source, as many of the investments were sold to pay for necessary imports.

3. *Receipts from Banking and Insurance.* Under this heading

may be included commissions paid to dealers in the numerous commodity markets of London who complete contracts of purchase or sale on behalf of overseas customers. In a large number of cases such dealings are also financed through the medium of the British banking system which earns profits and commissions for the services which it renders. Further, these services are often employed in respect of transactions entirely between overseas countries. Finally, British insurance companies transact a large volume of business on behalf of foreign clients, and this involves the receipt of premiums. Income from these and other sources in 1958 was about £370 million.

In addition to the above-mentioned classes of income from services, there are certain miscellaneous sources of income such as that from tourist expenditure, and film royalties.

Direct Services. It has already been seen that many human desires can be satisfied only by direct personal service. For example, the desire for enlightenment calls for the services of the teacher, preacher, or writer; the cravings for amusement are satisfied by the music-hall artiste or the cinema operator; the desire to be freed from pain gives rise to the personal services of the doctor, dentist, or nurse; whilst the fear of invasion and need for protection generally call for the services of soldier, sailor, judge, etc.

RECENT TRENDS IN BRITISH INDUSTRY.—Although the advantages enumerated above have served to give Great Britain a substantial lead over her industrial and commercial rivals, even before 1914 her supremacy had received a strong challenge. As a result of a number of factors of great complexity arising partly out of abnormal war-time conditions, her difficulties have been intensified in recent years. Dependent as she is upon overseas markets for the prosperity of her great staple industries, it is inevitable that the disturbed international conditions since 1918 and her involvement in two long wars should have proved injurious to her trade. Political disturbances, currency fluctuations, and protectionist policies have been widespread, and are, one and all, detrimental to the smooth flow of international commerce.

Yet, in viewing the position and progress of British industry at the present day, it is easy to be misled into false conclusions of an over-pessimistic nature. The commanding industrial lead gained in the last century over other countries has not been maintained,

but a moment's consideration is sufficient to show that it was not possible to maintain it when other nations began to devote their energies to industry and commerce as assiduously as Great Britain alone had previously done. The acid test of economic success is to be found in the standard of living of the inhabitants of the country, and it is manifest to all that the average standard of comfort in this country has risen immensely as the result of its industrial prosperity during the last century. It is no slight thing that these islands, unable even to provide their present inhabitants with the means of life, to say nothing of luxuries, have created exchangeable wealth with which not only the means of sustaining existence but also an ever-rising standard of refinement and comfort have been obtained.

The growing competition before 1939 of foreign industries assisted by Government intervention in the form of tariffs and subsidies created prolonged depression and unemployment in the exporting trades such as coal, metals, engineering, and textiles. This depression has to a considerable extent distracted attention from developments in other fields and has engendered an over-pessimistic attitude. In the case of the leading industries of the industrial revolution, which were the great labour-absorbing industries of the nineteenth century, we find no additional employment, but a contraction. In the period between 1923 and 1947 the number of persons employed in cotton manufactures and coal-mining fell by 58 per cent and 38 per cent respectively.

If now we turn to the group of technical manufacturing industries, mainly dependent upon recent invention, such as rayon, radio, motor, cycle, aircraft, chemicals, and so on, we find very substantial development of capacity to absorb labour. Industries showing the greatest expansion between 1923 and 1938 were silk and artificial silk, with 113 per cent increase in employed persons; the motor industry with 104 per cent increase, and the electrical industry with 97 per cent increase.

Industries showing the greatest expansion since 1938 are scientific instruments; motor vehicles and aircraft; engineering; rayon and nylon; and electrical equipment.

The present position in industry is one of "full employment," i.e. there are more vacancies than there are available workers to fill them. This has brought about a rise in the cost of labour, a further

stimulus to finding labour-saving devices and methods and further mechanisation of production. In some large industries "automation" has been introduced, that is to say machines are linked together and materials automatically passed from process to process so that a number of successive operations can be directed from a control desk without human intervention at each stage and materials handling between each of the processes.

TEST PAPER

1. To what extent is the industrial prosperity of Great Britain due to natural advantages?
2. Enumerate the leading extractive occupations of Great Britain.
3. What are the chief factors which determine the distribution of the British manufacturing and constructive industries?
4. Explain what is meant by invisible exports, taking, as an example, the transactions between Great Britain and the United States.
5. "Imports must be paid for by exports." Explain this statement, and consider what must be included under each heading to make it true.
6. Show, from your knowledge of the industries of Great Britain, that Commerce is always closely connected with extraction or manufacture.
7. Enumerate twenty different callings in the neighbourhood in which you live, and classify them.
8. Account for the localisation of industries in Great Britain by reference to particular instances.
9. "All the men of all lands have become necessary to one another for the exchange of the fruits of industry and the products of the soil." Discuss the above statement with special reference to the British Isles.
10. Is it true that England is being impoverished by her foreign trade, because the imports largely exceed the exports in value? Account for the excess in value of the imports.
11. How do economists understand the terms Production and Distribution? Does the so-called "distributive" trade, such as shopkeeping, pertain to production or to distribution in the economist's sense of these terms? Give reasons.

SECTION III—COMMERCE

CHAPTER IX

The Modern History of Commerce

Modern commerce may be said to date from the time when steam was applied to machinery, and thus gave rise to the system of industry on a large scale. Seven periods may be distinguished—

(1) The Industrial Revolution, 1760–1820.
(2) The Period of Free Trade, 1820–1870.
(3) Period of International Rivalry, 1870–1914.
(4) First World War, 1914–1918.
(5) Period of Peace and Recovery, 1919–1939.
(6) Second World War, 1939–1945.
(7) Period of Reconstruction.

(1) **THE INDUSTRIAL REVOLUTION: 1760-1820.**—The phrase "Industrial Revolution" seems to have been the invention of Mr. Arnold Toynbee, and was applied by him to a series of conspicuous changes which occurred in the aspect of British industry, and afterwards spread over the whole of the civilised world. This series of changes coincided roughly with the period from 1760–1820; and, taken collectively, they certainly do indicate a vast and comparatively rapid alteration in industrial conditions, a vast and rapid increase in man's comprehension of Nature, and, therefore, in man's power to control natural forces.

The word "Revolution" as applied to these changes can scarcely be said to be well chosen. The changes, it is true, were great, and it is the magnitude of those changes that has justified the application of the word "Revolution," and has since secured the acceptance of the term by economists. But, in reality, these changes no more constituted a revolution in the proper sense of the word than the opening of the rose-bud into the rose. It was a development—an evolution—partaking of the nature of what is known in biology as metamorphosis, but nothing of a revolution in the truest sense.

England in 1760. A survey of England in 1760 would have shown

that its industries were being carried on by methods that are best described as "still surviving": that is, they were methods that were dying out, but they were just then still in existence.

The great changes that were to come were due to the fact that about this period the new methods were asserting themselves, and the adoption of new industries rather than the development of old industries marks the period. Up to the time of Elizabeth, what was called "cotton" had been a sort of woollen cloth, and it is remarkable that Adam Smith only mentions the word "cotton" once in his *Wealth of Nations*. It was in 1760 that the fly-shuttle, which was the first attempt at weaving machinery, was applied to cotton weaving; and in 1769 Arkwright patented his spinning roller, which was known as the spinning "jenny."

Mr. Bains, the historian of the cotton industry, says that the English cotton machinery was absolutely primitive at this period, and was the same to all intents and purposes as that in India. It was worked in the homes of the people in the forms of industry known as the "Domestic System." Under this system, the employer gave out the material to be worked up in the homes of the people where they possessed a loom or a spinning-wheel. Hence, the period begins with invention.

The great inventions, which, when once born into the world, were to grow with a mighty growth, were to constitute the large-scale industry.

By 1777, there were indications of the change. There were riots in Somerset against the owners of machinery. At the beginning of the eighteenth century, wages were settled by magistrates, but that system of fixing wages was dying rapidly in 1747; and by 1760 it was here and there surviving. By 1795, however, the system had been abolished.

The *population* in 1760 cannot be ascertained exactly, but estimates have been made by more or less skilful observers. One such estimate states that from 1700 to 1750 there was an increase from a little over five millions to a little over six millions, or from 17 to 18 per cent in the first half of the eighteenth century.

In 1801 there had been an increase to over nine millions, that is to say, more than 52 per cent in the second half of the eighteenth century; and the change marks the difference between the results of the old industrial organisation and the new. More striking

even than the quantity of the population, was the change in its local distribution.

At the beginning of the eighteenth century, England north of the Trent was very sparsely populated indeed; but by 1801 it contained one-third of the vastly increased total.

Between 1700 and 1750, for instance, there was an enormous increase in Lancashire, in the West Riding of Yorkshire, Somerset and Wiltshire, and especially in those districts where the textile industries were developing. Among the increases were—

NORWICH . .	30 per cent	BIRMINGHAM .	Sevenfold
WORCESTER .	50 ,,	LIVERPOOL .	Tenfold
SHEFFIELD .	Sevenfold		

Where trade and manufactures were closely connected, the population seemed to advance by rushes. Again, the towns were absorbing an increasing proportion of this population.

It is estimated that in 1696 London contained about one-tenth of the whole population, whereas in 1766 London contained one-sixth of the whole.

Trade and Manufactures. In 1760 the woollen trade was still the principal industrial interest, and was distributed fairly evenly over the country; and the demand for wool led to the demand for sheep-runs. Next in importance after wool stood iron, which was then carried on as a decaying industry surviving in the Weald of Sussex and along the North Downs.

It was in 1755 that iron and coal works were first started at Merthyr Tydvil.

In 1760 the manufacture of cotton was quite insignificant, the production of wool being twenty times as great.

At the present time the production of cotton goods is much greater than that of wool. The chief centres of cotton manufacture were Bolton and Manchester in Lancashire, where the temperate climate was remarkably well suited to the production of cotton goods.

It was in 1760 that the fly-shuttle began to be used in Lancashire; then came the development of the larger market, with its division of labour. Prices then became lowered, and this, in turn, gave rise to a still wider market. The prosperity of the towns began to influence the country, and the land was being bought up in large quantities by rich men, so that the yeomen gradually vanished.

They had been gradually disappearing down to the year 1700, but up to that time they represented about one-sixth of the population of England. The causes of the disappearance of the yeomen were social and political, rather than economic. Land was the source of political power, and the poor man could not resist the rich man's price.

This transition from the old form of industry to the large-scale machine production was marked by a series of important inventions.

In 1767, Hargreaves invented his "spinning jenny"; in 1769, Arkwright his cotton-spinning machine; in 1788, Cartwright the first mechanical weaving loom. The invention of the steam-engine by James Watt in 1763 brought with it a complete transformation in almost every branch of industry. Through the practical utilisation of this and numerous other inventions and discoveries, English industry was enabled to outdistance all competitors.

Agriculture. The changes which were taking place in agriculture during this period are often referred to as the Agrarian Revolution. The period was characterised by a great deal of enclosure of land. In England, there have been three great periods of *land enclosure*, but never before had land been enclosed with such rapidity or to such an extent as during this period of the Industrial Revolution.

The *enclosures* of the eighteenth and early nineteenth centuries led to the conversion of common land into private property, largely by means of Acts of Parliament. The causes of this movement were—

(*a*) The absence of all labour-saving machinery in agriculture, the development of large-scale farming, and the increased application of division of labour.

(*b*) The displacement of the small yeoman farmer, who often sank to the level of the farm labourer, and, the consequent diminution in the price of labour.

(*c*) The increase in the number of private Enclosure Acts. In the reign of Anne, there were only three private Acts passed for enclosures; whilst from 1797 to 1810 there were 1,729 such Acts.

In 1856, commissioners were appointed to check enclosures, and later an Act was passed to prohibit further enclosures, unless the Commissioners explicitly decided that they were for the public good.

From 1710 to 1760, there were about 335,000 acres of land enclosed; whilst from 1760 to 1843 it amounted to 7,000,000 acres. These changes had advantages as well as disadvantages. The common tillage had been exceedingly primitive, and it was the enclosures which brought about improvements. Agricultural invention had come very late; and in 1760, the commencement of this period, the wooden ploughshare was still in use.

In 1760, the mercantile system of close and constant interference with trade and industry was still in existence, although the economic thought of the world was soon to be revolutionised by the publication of that wonderful work, *The Wealth of Nations*, in which Adam Smith, with a chain of resistless logic, revealed the unutterable weakness of the mercantile theory.

Features of the Revolution. The chief facts which emerged, and which constituted the Industrial Revolution, are as follows—

1. The great change of population in regard to both quantity and distribution.

2. The decline in the proportion of the population engaged in agriculture, and the shifting of the centre of gravity of the population from the Midlands to the manufacturing district of the North.

3. Great changes in agriculture itself. The destruction of the common-field system; the enclosures of waste land and commons; the growth of large farms and the rapid advance in the most scientific kinds of agriculture, particularly in the rotation of crops; the introduction of the steam-plough: these changes produced an immense improvement in the productiveness of agriculture.

4. In manufactures, the domestic system gave way to the factory system.

5. The great increase in the means of communication; the railways, the first of which was built in 1830, taking the place of the canals.

6. The growth of large towns on the coal-fields.

7. The separation of the farmer and the labourer in agriculture, and the capitalist and the worker in the factory.

(2) **PERIOD OF FREE TRADE: 1820-1870.**—In 1786 an attempt had been made to modify the rigidly protective legislation of the eighteenth century. In that year, Pitt concluded a commercial treaty with France, providing for large reductions of duties in both countries. But the treaty was swept away with the outbreak of

the Napoleonic Wars, and accordingly the old system of Mercantilism was still in force in 1820.

The first important step, and in some respects the decisive step towards modifying it, was in 1824, under the policy of Huskisson. In that year, and again in 1825, great reductions were made in the duties on raw materials, while considerable reductions were also made in the duties on manufactured goods. The most sharply contested of the changes were in regard to silks, which had been completely prohibited but were now admitted at a duty of 30 per cent. A considerable breach was thus made in the protective system.

In the decade from 1830 to 1840, the *Corn Laws* were the chief subject of contention. The great increase in population since the middle of the eighteenth century had made England a corn-importing country, especially with the rapid growth of manufactures in the early years of the nineteenth century.

The first systematic Corn Laws, imposing duties on grain, had been passed in 1773. From 1816 onwards, a series of measures was passed, all designated to maintain the high price of grain. The Act of 1816 prohibited the importation of wheat, when the price was less than 80s. a quarter. In 1822, the prohibitive point was lowered to 70s.

In 1822 the *sliding scale* was introduced, under which the duty went up and down as the price of grain went up and down, and it was against this form of the Corn Law that the great agitation (led by Cobden and Bright) was directed after 1830.

For a long time the anti-Corn Law agitation seemed to have no effect, although conducted with extraordinary skill and enthusiasm.

In 1842, however, Sir Robert Peel made the first important concession, by modifying the sliding scale, his opponent, Lord John Russell, having proposed in the previous year a fixed duty of 8s. a quarter.

In view of the bad harvest of 1845–6 and the famine in Ireland in 1846, Peel surrendered; and proposed, in 1846, the admission of grain, with only a fixed duty of 1s. a quarter as a registration fee. This change was carried, but Peel, being able to carry only a fraction of his party with him, was compelled shortly afterwards to resign. The Corn Laws had great political strength, serving as they did the interests of the landowners, whose hold on Parliament

was still very strong; but the general economic situation in Great Britain, from the rapid growth of the manufacturing population and the imperative need of more food, made their abolition inevitable. The remodelling of the tariff system in the direction of Free Trade went on, little retarded by the maintenance of the Corn Laws and not much accelerated by their abolition.

In 1842 great reductions of duty were made on a large number of articles: in 1846 still further reductions of duty were made, whilst another series of changes came in 1853; and, finally, in 1860, the last remnant of protective duties disappeared.

The four Acts of 1842, 1846, 1853, and 1860—the first two under Peel's leadership, the second two under Gladstone's guidance—thus carried out the policy of Free Trade in regard to other articles than grain. The first of them, in 1842, was signalised by the introduction of the income tax as a means of raising revenue to replace that lost by the diminished import duties. The last of them, in 1860, was largely influenced by the great commercial treaty with France. In that treaty the concessions made to France were the reduction by Great Britain of duties on wines and spirits, and the admission, free of duty, of some important French products, notably silk manufactures, gloves, and other products in which the French had superiority

Great Britain, instead of limiting the concessions to France in 1860, made them applicable to all the world. The silk manufacture, as to which the first great changes had been made in 1824, and on whose products the duties had been kept higher in previous Acts than on other manufactures, was thus compelled, notwithstanding violent opposition, to face unfettered foreign competition.

The nature of the changes effected between 1842 and 1860 is indicated in the following figures—

Year.	Duties reduced.	Duties abolished.
1842–46. . .	503	390
1846. . . .	112	54
1853. . . .	—	123
1860. . . .	—	371

After 1860, only forty-eight articles remained subject to duty, a number which was still further reduced. From that date the English Customs tariff was simplicity itself. A very few articles, such as spirits, beer, wine, tobacco, tea, coffee, and cocoa yielded practically all of the Customs revenue; and so far as these articles were produced within the country, they were subject to an excise duty (i.e. an internal tax precisely equal to the import duty). Further, the advent of a pure Free Trade policy was accompanied in 1860 by the so-called Cobden Treaty between England and France, and was followed by a series of similar treaties with other countries, and there was a general movement throughout Europe for greater freedom of trade.

(3) **PERIOD OF INTERNATIONAL RIVALRY: 1870–1914.**—The hope that other countries would follow England in the adoption of Free Trade was not to be realised, and from 1870 onwards a movement in favour of higher duties spread over the Continent; whilst, in England, the opposition to Free Trade once more came into evidence. The chief factor which gave rise to this reaction was the increasing competition in manufactures and in commerce on the part of the United States and of Germany.

In 1880 began a protectionist movement in England under the name of Fair Trade—the principle that a country should treat the products of other countries in the same manner as the latter treat its products. This agitation to abolish one-sided Free Trade was followed by various other measures against the existing *laisser-faire* system, such as the Merchandise Marks Act of 1897, which required the place of origin to be indicated on all imported goods. This was directed chiefly against German competition, although many believe that it had the unexpected effect of advertising goods " Made in Germany." Further protectionist tendencies were manifested in the regulation of the importation of cattle, in the financial arrangements during the South African War, and more recently in the advocacy of Imperial Preference.

Although the trend towards combination started during this period, the dominant force in industry and commerce was still individualistic and competitive.

(4) **FIRST WORLD WAR: 1914–1918.**—During the Great War the whole organisation and machinery of production were subjected to abnormal pressure under the driving force of government and necessity.

There was immense speeding up of invention, technique, and organisation, leading to mass production over wide areas of industry.

During these years the government had to resort to extensive borrowing, with the result that there was a considerable rise in prices. At the same time the co-operation with the colonies led to the extension of Empire Unity. The Colonies received much benefit owing to the stopping of a great many European exports. Goods which many countries had obtained from Germany they now tried to produce for themselves, so that the war period was one of extensive factory building in British Colonies, and a Colonial industrial revolution may be said to have taken place at this time. British trade was hampered owing to submarines, and in 1915 duties were placed upon what were considered non-essential goods in order to discourage their import and thus have more vessels free to carry more important goods. A preference system with the colonies was further extended, and in 1917–1918 the Imperial War Conferences were held.

(5) **PERIOD OF PEACE AND RECOVERY: 1919–1939.**—For some years after the first World War it was really doubtful whether Europe and Great Britain were recovering or were going to recover from these disastrous four years. Many thought that we were slipping downhill and would be unable to arrest our fall and that after a long period of distress, revolution and social disruption, the Europe which would emerge would be on a permanently lower level of prosperity and civilisation. Happily these darker fears for the future were not realised. European civilisation did, indeed, for a time totter in the balance, but when once the turn towards recovery was taken progress was surprisingly favourable. New inventions and increased skill enabled men with a given amount of effort to wrest more from nature and make more from her products. The war interrupted the growth of prosperity, but it did not permanently stop or reverse the process. In 1939 the world was richer than in 1914. Production had, since the war, increased by about 25 per cent, while the world population had increased only by about 10 per cent. The difference between these two figures indicates the real rise in the average standard of living. The world would have been, of course, much richer had there been no war; but in 1939 it had already grown richer than it was before the war. This of course is only true of the world as a whole; it is not true of

every continent, still less of every country, still less of every class. In North America, in South America, in most of Asia, in Africa and in all the British Dominions, in every continent except Europe, there had been rapid and striking progress. It was Europe which was impoverished by the war. For Europe the war meant, instead of increasing prosperity, a decade of impoverishment and then a slow resumption of progress up to the point reached in 1914. The position of our own country was rather worse. More than any other great country we depend, and must depend, on our export trade. We therefore suffered specially from the hindrances to world trade.

Let us glance rapidly at the principal stages in Britain's recovery and subsequent relapse into war. First we had the stage of emergency measures. Many countries were in 1919 short of the most elementary necessities. Food and raw materials had to be found in ships. There were not enough ships. Railways had to be repaired; the complicated restrictions of the blockade had to be cleared away; prisoners of war had to be repatriated; soldiers had to be demobilised and both reabsorbed in the occupations of peace. These troubles occupied the first few years of peace. Secondly, as progress was made in these tasks more obstinate difficulties emerged. The whole mechanism of production had been adapted to war needs; there was not enough savings to acquire the new capital and the large reparation debt was for years a serious obstacle to the resumption of trade. Closely connected with these troubles, and for a time the most important of all, came the chaos of the currencies of Europe. For some years the fluctuations of European currencies were the worst impediment to economic recovery and worst of all to the trade of large exporting countries like our own. In nearly all countries of Europe the currencies lost value and in many countries of Europe practically ceased to have any value at all. As this trouble passed another came into prominence. Trade barriers and new and increased tariffs were introduced, and the trade of the world was distorted and destroyed. Autarchy with its ideal of self-sufficiency became the economic ideal, whilst in the political sphere a policy of aggression was adopted by Japan, Germany, and Italy which soon led to the outbreak of the second World War.

(6) **SECOND WORLD WAR: 1939–1945.**—In September, 1939, war broke out once more between the British Empire and France on the one hand, and Germany on the other—a war which by the end

of 1941 was to involve every Great Power in the world and to transform every continent into a battlefield. But the invasion of the Continent by the Allies in co-operation with the Russian armies on the Eastern Front proved too much for the Nazis, and they surrendered unconditionally in May, 1945. Japan surrendered in August, 1945, shortly after the first atomic bomb had been dropped by the Allies. The passing of the Lend-Lease Act in 1941 by the United States Government enabled Britain to receive armaments and foodstuffs without paying cash for them. In August, 1941, the United Kingdom and the United States made a joint declaration on the principles of the new world order to be established after the war. This was the Atlantic Charter, which aspired to guarantee for victors and vanquished alike access to raw materials and all the necessary conditions of a peaceful and prosperous life. In July, 1944, a conference was held at Bretton Woods in the United States, and the representatives of forty-four nations prepared plans for an International Monetary Fund for stabilising the exchanges and an International Bank which would help in reconstruction and development. Shortly afterwards, a conference was held at Dumbarton Oaks, which was attended by representatives from the United Kingdom, United States, Russia, and China. They recommended the establishment of an international organisation, the main purpose of which should be to maintain international peace and security, develop friendly relations among nations, and further international co-operation in the solution of the economic and social problems of the world. This organisation came into being in June, 1945, when fifty nations met at the United Nations Conference in San Francisco and signed the Charter.

(7) **PERIOD OF RECONSTRUCTION: post 1945.**—In 1945 a Labour Government came into office and was faced with the difficult task of reconstructing post-war Britain. The war had seriously reduced Britain's income from overseas investments and the problem which faced this country was how to pay for her essential imports of food and raw materials. This could only be done by building new factories and equipping them with the necessary machines so that goods could be produced for export. To aid in her recovery, Britain signed a Loan Agreement in December, 1945, whereby she would receive £1,100 million from the United States. A year later, a loan was negotiated with Canada to the extent of £280 million.

An important feature of the Labour Government's programme was its policy of nationalisation, and this was applied to the Bank of England, the coal industry, civil aviation, road, rail and canal transport, and electricity and gas. In the cotton industry, the Government appointed a Cotton Commission responsible for the bulk purchase of raw cotton from abroad.

On 5th June, 1947, Secretary of State Marshall, in a speech made at Harvard, suggested that European nations should meet to consider plans of mutual aid and the role America might play in their reconstruction. A month later the meeting took place and sixteen nations discussed a European recovery programme. The U.S. Government agreed to an aid programme for Europe of $5,300 million in the first year and a four year total of $12,000 to $17,000 million. The sixteen nations which accepted Marshall aid formed the Organisation for European Economic Co-operation (O.E.E.C.) the object of which was to allocate funds and co-ordinate national recovery plans. In April, 1948, the Economic Co-operation Administration was set up by the Americans to administer the European Recovery Programme and review O.E.E.C. projects.

The process of rebuilding European industry has gone on slowly but surely since 1945, and its productivity has increased quite considerably. But the effects of the second World War went so deep that a succession of financial, fuel, and power crises have interrupted the path of recovery. Unfortunately, too, political peace has not resulted, and the world has been divided into two large power blocs —the West led by the U.S.A., and the East consisting of the U.S.S.R. and its satellite powers. The constant state of "cold war" which has resulted has forced all countries to maintain very considerable armaments expenditure and the locking up of manpower and raw materials in defence activities. If the men, money and materials absorbed by these activities could be turned to peaceful uses there is little doubt that the rate of recovery would be vastly accelerated and a considerable increase in world standards of living could be brought about.

TEST PAPER

1. What was the "Industrial Revolution"? Point out the chief features of the change which came over the Industry of England at this time.
2. Justify the title "Industrial Revolution" as a description of the economic changes which passed over England at the close of the eighteenth and beginning of the nineteenth centuries.

3. Give an account of the organisation and diffusion of the woollen industry in England in the period immediately preceding the great mechanical inventions.

4. Describe and explain the general change in the nature of the manufacturing industry of England at the end of the eighteenth century.

5. " England in the Tudor Period is still primarily a country engaged in agriculture." What conditions gave rise to the subsequent development of manufactures and commerce ?

6. Describe the " Domestic System " of manufacture.

7. Point out the marked changes in the industrial methods, appliances, and means of communication of the nineteenth century, and describe the results of such changes.

CHAPTER X

The Establishment of a Business

Manufacturing, commercial and direct services businesses may be organised in a number of different types of formation. Competitive businesses may be conducted by one of the following—

(*a*) Sole Trader.
(*b*) Partnership.
(*c*) Joint Stock Company (Private or Public).

Certain activities are conducted by Co-operative Societies and some other industries are now organised in a monopolistic form as Nationalised Industries.

These are the only individual business forms, but groups of businesses may further combine to form trust and cartel-type organisations, trade associations and Chambers of Commerce.

These different types of organisation will be reviewed in this and the succeeding chapter, the latter being devoted to a full account of the formation and organisation of the Joint Stock Company—a particularly important form of organisation in modern commerce.

The student should consider these separate units of business organisation from the point of view of the provision of capital, the disposal of profits and losses, the liability of the proprietors and the obligation to keep accounts.

In the case of sole trader and partnership concerns, the proprietors who put up the capital which the business is to use are also the people responsible for the direction and policy of the business. There is little legal restriction on the setting up or control of these businesses since only the proprietors' own capital is being risked, and these businesses are individual concerns in which the proprietors are legally responsible as individuals for the contracts made by their businesses. In return for this wide freedom of action they are held fully liable for the debts of their concerns and this liability is unlimited—that is to say they may lose not only what they have put into their businesses as capital but also any other financial resources which they may personally have outside the business.

Joint stock companies and the remaining types of organisation,

however, are organisations in which the provision of capital and the control of the business are divorced. Shareholders or stockholders provide the capital, while the direction of the business is in the hands of a board of governors or similar group of people who are responsible for policy and control. Here there is a rigid procedure of registration, an obligation to keep accounts and have them properly audited, annual returns to be made and, in return for this, a limitation of the liability of the shareholders and stockholders to the value of their respective holdings—that is to say they may lose all the money they have invested in the business, but they are not liable to put up any further funds to satisfy the creditors of the business if it gets into financial difficulty.

In accordance with the provisions of the Registration of Business Names Act, 1916, undertakings carried on in the United Kingdom under other than the true names of the owners must be registered with the Registrar of Business Names. In practice, the effect of this Act is to render it necessary to register the full Christian name and surname, and nationality if foreign, of every such sole trader or member of a partnership firm. In regard to Limited Companies, the same requirements as to registration and identity of the directors is required by the Companies Act, 1948. This is a protection to traders giving credit, who may reasonably desire to know the exact constitution of a concern with which they propose to deal.

SOLE TRADERS.—A sole trader is a person who carries on business exclusively by and for himself. The leading feature of this kind of concern is that the individual assumes full responsibility for all the risks connected with the conduct of the business. He is not only the owner of the capital of the undertaking, but is usually the organiser and manager and takes all the profits or responsibility for losses. The activities of such a concern are, as a rule, confined to a certain locality, and but seldom extend beyond the limits of a given country. This is usually due to—

(1) Scarcity of capital ; (2) Limitation of managerial ability.

The chief types of concerns which take the form of organisation of the sole trader are retailers, hawkers, costermongers, and persons engaged in rendering direct services. In such concerns a simple form of organisation alone is required, and personal supervision can be exercised with success.

LEGAL CONSTITUTION OF INDIVIDUALISTIC CONCERNS

	Sole Trader.	Partnership.	Limited Partnership.	Public Limited Company.	Private Limited Company.
1	Consists of one person, viz., the owner of the business.	May consist of from 2 to 20 members (except in a banking partnership where they must not exceed 10).	Consists of one or more General Partners, and one or more Limited Partners. (The maximum number of members is 20, and in the case of a bank 10 members.)	Cannot consist of less than seven members.	May consist of 2 members, but not more than 50 (excluding employees and ex-employees).
2	The proprietor is personally liable for all the debts of the business.	Partners are liable for the full amount of the debts of the partnership.	The General Partners are liable without limitation for the debts of the firm. The liability of Limited Partners is limited to the amounts they contribute.	Each member's liability is limited to the nominal amount of capital undertaken to be contributed by him.	The members' liability is the same as in the Public Limited Company.
3	The proprietor may dispose of his business at any time.	Shares are not transferable.	A limited partner may transfer his share with the consent of the general partners.	Shares are freely transferable.	There is a restriction on the transfer of the shares.
4	Audit of the accounts is optional.	Audit of the accounts is optional.	Audit of the accounts is optional.	The audit of the accounts is compulsory.	The audit of the accounts is compulsory.
5	The Capital is introduced by the Proprietor, but he may obtain the use of outside loans.	The partners named in the articles of partnership introduce the capital.	The capital is introduced by the General and Limited Partners.	The public may be invited to subscribe the share capital.	The public must not be invited to subscribe the capital.
6	An annual balance sheet is not compulsory.	An annual balance sheet is not compulsory.	An annual balance sheet is not compulsory.	An annual balance sheet is compulsory, and a statement in the form of a balance sheet must be filed annually, at the Companies Registration Office.	An annual balance sheet is compulsory. It must be filed at the Companies Registration Office, except in the case of an "exempt" private company.

PARTNERSHIP.—According to the Partnership Act of 1890, partnership is the relation which subsists between persons carrying on a business in common with a view to profit. The Act lays down rules for determining whether or not a partnership exists. The mere fact that a person receives a payment out of profits is not by any means conclusive evidence of partnership. To constitute partnership, there must be evidence that the business is being carried on in the interest of the persons seeking to be held as partners. The fact that a retired partner or a widow of a deceased partner receives a share of the profits does not make them partners. It gives them neither the liabilities nor the rights of partners.

The chief characteristics of a *partnership* are—

(1) Each partner is personally liable for the whole of the debts of the firm.

(2) The capital is usually contributed by the partners themselves.

(3) The profits or losses resulting from the conduct of the business are shared by the partners.

In an ordinary partnership, every partner is an agent of the partnership and is able to bind the firm in the ordinary course of the firm's business. If any serious alteration is proposed in the conduct of the business, it must be agreed to by all the partners. For example, if it is proposed to change the location of the partnership, or open a branch, they must all agree.

It is not uncommon for those who have their capital in the business and who have grown old, to take into partnership young men who have no capital. In this case, however, such partners do not always possess the right to veto any alteration in the conduct of the firm. One generally finds the rights of junior partners curtailed.

In professions, it is quite a common thing to have a partner who has no capital in the business and who has no interest in the goodwill. Sometimes he is remunerated by a share of profits, sometimes by a salary plus a share of profits, and often merely by a fixed salary. Such a partner is known as a *Salaried Partner.* The term suggests a partner with quite limited powers, whose position is not much more than that of a manager, but as regards the outside world he is looked upon as a partner, and is liable as such.

LIMITED PARTNERSHIP. The Limited Partnership Act of 1907 provides that a Limited Partnership must consist of one or more persons called *General Partners,* who shall be liable for all the debts

and obligations of the firm, and one or more persons to be called *Limited Partners* who shall not be liable for the debts or obligations of the firm beyond the amount contributed.

This form of partnership is a development of the Continental idea, under which financiers, including bankers, may put capital into a business and receive in return a rate of interest varying with profits without being liable as partners. A limited partner has no liability for the debts of the partnership beyond what he has put into the business. He is not allowed to take part in the management, but he can give advice. If things are going badly, however, and he tries to make the business better, he might be held to have taken part in the directing of the business as a general partner.

THE JOINT STOCK COMPANY.—A company in the widest sense of the term means an association of several persons who contribute money to a joint or common stock and employ it in some business, and share among themselves the profit or the loss arising from it. A company means an incorporated company. If a company is not incorporated, it is in reality a large partnership, even though it may be called a syndicate, and is governed by the law of partnership. But every association of more than ten persons for carrying on the business of banking, and every association of more than twenty persons for carrying on any other kind of business that has for its object the acquisition of gain, must be formed and registered as an incorporated company.

An ordinary trading company is incorporated by registration under the Companies Act, 1948 ; and, in the great majority of cases, the liability of the members of the company is limited to the nominal amount of their shares. Every such company must have as the last word of its name the word "*Limited*," and the name of the company with the word "Limited" must be affixed to the outside of the place in which the business is carried on, and must also appear on all documents issued or used by the company. But where an association is about to be formed for the purpose of promoting commerce, art, science, religion, charity, or any other useful object, and the founders are willing to form it on the footing that its profits or income shall be applied exclusively in promoting the objects of the association, and that no dividend shall be paid to its members, the Board of Trade has the power to grant a licence authorising the registration of the

association with limited liability but without the addition of the word "Limited" to its name.

The essential difference between a company and a partnership is that a partnership is merely the aggregate of its individual members, whereas a company is a body corporate, or a corporation which, in point of law, is a person just as much as an individual, although its object is to limit his liability. It may sue or be sued in a legal action as a company.

THE PRIVATE COMPANY. The Companies Act, 1948, provides for the formation of companies of two types limited by shares, namely, public and private companies. The Act, in Section 28, lays down the conditions which must be complied with if a company is to enjoy the privileges of a private company. These are—

(1) *Restricts Transfer of Shares.* A private company must, in its Articles of Association, restrict the rights of its members to transfer their shares. This does not mean that transfer is prohibited, but that the inherent right of transfer which shareholders usually possess must be modified so that no open market dealing takes place. As a general rule the articles restrict transfer to specified relatives of the member or to other members, giving the latter an option of purchasing before any transfer is made to outsiders.

(2) *Limits Membership to Fifty.* A private company may consist of a minimum of two members and a maximum of fifty, whereas a public company has a minimum of seven and a maximum of the number of shares issued (which in practice is never reached since most members take a block of shares). This provision is relaxed by making an exception in the case of past or present employees of a private company who have become shareholders whilst in the service of the company. This exception was inserted to encourage the introduction of profit-sharing and co-partnership schemes which might have been beyond the power of a private company if such employee shareholders had been included in the maximum membership of fifty.

(3) *Prohibits Invitation of Public Subscription.* A private company is prohibited from appealing to the public for subscriptions to an issue of shares or debentures, whereas in the case of a public company this is, of course, the customary method. Hence the private company must raise its capital requirements from a restricted circle of investors and, in the event of additional capital becoming

necessary to finance new developments, cannot resort to an appeal to the public without losing its status as a private company.

We may regard the private company as a kind of transitional form of legal constitution between the public company and the partnership. It confers the privilege of limited liability upon its members and yet is subject to a minimum of restriction by the law. Under the Companies Act, 1948, a private company must now file a certified copy of the balance sheet with the annual return. A new category of private company called the "exempt private company" retains the privilege of not filing its accounts with the Registrar of Companies. Again, a public company must have a minimum of two directors, whereas in the case of a private company this requirement does not apply. The private company, therefore, provided it complies with the statutory requirements, can conduct its business on very similar lines to a partnership, except that the members of such a company enjoy the important advantage of limited liability. Finally, private companies afford facilities to the testator whose capital is sunk in his own business to divide his estate among his relatives without disturbing the financial arrangements of the undertaking, and at the same time limiting the liability of those to whom the business is left.

Frequently the shareholders consist only of the members of one family, yet if one person holds nearly all the shares, the company is still regarded as a distinct entity. In this case it is spoken of as a *one-man* company.

Both private and public joint-stock companies receive their capital from shareholders, and whatever profits the directors decide to distribute to shareholders are given as dividends on the shares held.

CO-OPERATION.—Those who want some particular kind of commodity may combine together and themselves establish a business, so that they may be regarded as the proprietors and also the customers of that business. There are many examples of such co-operation, although the precise organisation varies somewhat under different circumstances.

In connection with the business of insurance, there is a whole group of concerns which might be brought under this heading. The most obvious form is what are called mutual offices, which sometimes deal exclusively in life assurance and sometimes in life assurance combined with other kinds of insurance. The distinctive feature of such

concerns is that the policy holders are the sole proprietors, and whatever profits there are may be applied in strengthening the financial position, in reducing future premiums, or in making a return at the end of the year of a portion of the past year's premiums.

Another form of co-operation in kind, although not in name, has arisen in connection with what are called "building societies." *Building societies* are rather peculiar institutions, in that they are organised on different lines from other business concerns. The function of a building society is really twofold—

(1) To receive deposits from those of its members who may care to invest money with it at interest; and

(2) To lend out, from time to time on the security of mortgage of leasehold or freehold property, such money as it may have.

Hence, the business of a building society resembles that of a bank or money-lending society. The distinctive feature of a building society is that it locks up its assets, whereas it raises the money which it lends in this way from other parties, who, when it suits them, can ask for the return of their money.

What is ordinarily meant by a *co-operative society* is a society registered in this country under the Industrial and Provident Societies Acts. Under these Acts societies may be formed which for all practical purposes are limited companies with a difference. Like limited companies, they may carry on any desired kind of business. On the other hand, like building societies, they raise their capital either by accepting loans repayable at short notice or by issuing so-called shares, which are paid up by weekly or monthly instalments. These industrial and co-operative societies mostly run a general stores, and for the most part buy what they sell from a central society formed on similar lines, which is called the Co-operative Wholesale Society. The idea is that the consumers, by combining, shall be able to eliminate the profits of the middleman and capitalist, and obtain for themselves all the profits connected with the supplying of the goods which they require for their own use. At the end of the year, when profits are ascertained, dividends are paid *pro rata*, according to the purchases of the various members during the year, the capital receiving only a fixed rate of interest, which is agreed upon beforehand.

NATIONALISED INDUSTRIES.—Certain businesses, because of their natural monopoly nature, the predominance of the strategic or

public interest in their effective operation or their unprofitable but necessary nature, cannot be adequately supplied by competition.

The Postal service, wireless and telephonic communications, and the provision of adequate educational and hospital and health services are examples which have always been recognised as a responsibility of the Central Government in this country, although administration in detail is sometimes delegated to local authorities.

There are also certain essential public services, such as transport and the provision of water, gas and electricity supplies, which have recently become the responsibility of nationalised boards. These are services which in the public interest must be supplied at a reasonable cost, which call for a very heavy investment in specialised installations unsuitable for any other purpose and which, if only permitted to pay dividends out of current profits, would not show any investment return for a long time after their initial installation. This capital cost is too heavy to permit competition to ensure an adequate and reasonably priced service, so local monopolies must be created and the public protected from those monopolies, and they in turn must be protected from the public when they require to requisition property or rights of passage over or under other people's property to complete their installations.

These public services used to be operated in many cases by Public Utilities which obtained their capital from the public by the issue of stocks or shares, as does a joint-stock company, and paid dividends to stockholders from profits, but they were set up by special Act of Parliament which carefully regulated their operation. They were allowed initially to pay dividends out of capital until the business began to pay its way; they were given local monopoly and also compulsory powers of purchasing property or rights necessary to their efficient operation. A restriction was placed on the limits of dividend distribution to ensure that excess profits were largely applied to reducing the cost to the public of their services, and they were answerable to an appropriate local or central Government department.

This type of business activity has now mainly passed into the sphere of nationalised industry. Here the capital is provided from money invested in Government securities upon which a fixed rate of interest is paid whether the nationalised business makes a profit or not. The profits or losses of the business fall upon the Treasury and

lighten or increase the load of taxation which the Chancellor of the Exchequer must apply to the taxpayers of the country each year. Government representatives and technicians of the industry constitute a Board or Commission which is appointed to run the business, and this controlling group is answerable to the appropriate Ministry for the conduct of the business.

Coal-mining, which before the last war was conducted by many separate private concerns, was nationalised in 1946 when it was obvious that considerable modernisation and large-scale investment in the mines was necessary to make them productive again. The many small concerns in the industry could obviously not afford the large investment and unification of methods which was desirable.

The Bank of England was also nationalised in 1946.

GROUP ORGANISATIONS.—Sometimes persons or business houses will form a temporary or permanent combination to achieve some particular purpose in connection with a specified trade or profession. If a combine is formed, and it is agreed that a particular article shall not be sold for less than a certain price, then a monopoly is set up. A combination can work a monopoly so long as it is strictly a monopoly, but it very often breaks down for some reason or another. The most highly developed form of combination is known as a trust, and originated in America. The cause of the development of trusts is to be found in the concentration of production which arises when competition acts upon improved processes and leads to the invention of better processes. For undertakings of that kind, large capitals are required, so that only large businesses could take them up, and where inventions or discoveries, such as petroleum, etc., have been made, the large scale enterprises have tended to absorb the smaller ones.

A trust is really a partnership of companies and is usually incorporated as a *holding company*. Each company involved remains a legal entity, but the control definitely passes to the holding company and the actual business policy of the subsidiary companies will inevitably be changed, having regard to the interests of the combine as a whole. Thus the shareholders of a number of separate companies agree to combine into a trust, and thus surrender their shares to one central board of trustees. This board receives an irrevocable power of attorney to act for the

shareholders, who receive in return the trust certificates which represent their share in the undertaking, and the profits are divided among the shareholders according to the number of certificates held.

Where competitors are powerful but few in number, they often come to some understanding among themselves with regard to the sale of their goods. This agreement may have reference to terms of payment, or regulation of output, but so long as the parties to the agreement retain their separate existence as single businesses, the combination is some form of cartel, and differs from the trust in being a looser form of combination.

To obtain some of the advantages of larger scale organisation but without surrendering any measure of control over their individual conduct units will also form themselves into Trade Associations, or join Chambers of Commerce.

The Trade Association can be the mouthpiece of a whole industry or trade made up mainly of small units and will negotiate on behalf of the whole group with the Government, the Trade Unions and other industries. The Association can conduct propaganda, public relations, advertising, research and legal activities on behalf of its many members.

The Chamber of Commerce performs similar services, but whereas the Trade Association represents a particular group activity the Chamber of Commerce is a regional organisation representing members of many different trades or industries in a given area.

TEST PAPER

1. What is the meaning of "limited liability" as applied to a joint-stock company? Why do sole trader and partnership businesses have "unlimited liability"?
2. Compare, in tabular form, the relative advantages and disadvantages of Partnerships, Private Companies and Public Companies as forms of business organisation.
3. Distinguish between concerns which are worked on a co-operative basis and those which are essentially individualistic.
4. Mention some of the chief types of co-operation.
5. Say what you know of Mutual Insurance Societies, Building Societies, and Industrial and Provident Societies.
6. What is a "nationalised industry" and what reasons exist for promoting this type of organisation?
7. Compare nationalised undertakings with those which are privately owned and controlled.

8. What are the advantages and disadvantages of a partnership?

9. What relative advantages accrue to the carrying on of a business by (*a*) an individual, (*b*) a firm, (*c*) a private limited company? What classes of businesses are best suited to each of these three categories and why?

10. Who precisely obtains the profit or suffers the loss arising from industrial enterprise in—

(*a*) A private business.
(*b*) A public joint stock company.
(*c*) A co-operative retail society.
(*d*) A nationalised undertaking.

Do you consider this question important in considering the probable efficiency of the enterprise?

11. Compare and contrast—

(*a*) A trust and a cartel.
(*b*) A trade association and a Chamber of Commerce.

CHAPTER XI

The Joint Stock Company

JOINT STOCK COMPANIES AND COMMERCIAL DEVELOPMENT.—The general trend of modern business enterprise is in the direction of an increase in the size of the typical unit engaged in most industries and trades. This tendency may be ascribed to two sets of causes, namely, technical progress and economic factors. In the first place, most manufacturing and constructional industries have, during the last one hundred years, seen the introduction of mechanical inventions, with the result that hand labour has been progressively displaced in favour of the machine. The new machinery has usually had the dual effect of stimulating output and reducing costs of production, so that in the majority of cases lower selling prices have stimulated sales and have led to a progressive expansion in the scale of the enterprise. Yet even in those industries where mechanisation has not been so apparent, other factors have been at work to increase the size of the business undertaking. Attempts have been made at expansion in order to reap the benefit of certain economies which attend the conduct of business operations on a large scale—economies of buying or of selling, as in the case of retail trading organisations, or of specialisation of ability.

The result of this expansion, whether arising from technical or from economic motives, has been to increase enormously the capital requirement of the average industrial or commercial undertaking. There will be an increased outlay of fixed capital on factory buildings, plant, and machinery in the case of the manufacturing concern, and on business premises, fixtures and fittings, and the like in the case of the trading business. Again, the need for circulating capital will increase to a corresponding extent; stocks of raw materials and finished goods must be held, the wages and salaries of a large staff must be paid, more or less extended credits must be granted to customers, and heavy establishment charges must be met. Altogether, a very considerable capital investment of a permanent nature is called for and the problem arises of securing this.

The solution of the problem has been found in the evolution of the modern joint stock company which has been judicially defined

as "an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business, and who share the profit and loss (as the case may be) arising therefrom." The earliest associations of persons for trading purposes were of the *regulated* type, i.e. companies in which every member traded solely on his own behalf, subject only to certain regulations and restrictions imposed by each company. By the end of the seventeenth century, however, a form of organisation similar to that of the modern joint stock company had emerged, although it had, as yet, obtained no legal recognition, except by means of charters or special Acts. Many of these early joint stock companies obtained exclusive privileges for trading or for manufacture in return for a cash payment, a fact which led one writer to characterise them as "simply one of many shifty devices for raising money independent of parliamentary supplies." Much of the seventeenth century prejudice against the joint stock company was due to this monopolistic feature, which was frequently abused.

The early eighteenth century saw a wave of financial speculation, the outstanding example being connected with the South Sea Company, though the public lost large sums of money in projects much more uncertain and fantastic than this. The failure of this speculative boom produced widespread ruin and effected a vast redistribution of wealth, and led to the passing of the "Bubble Act" of 1720, by which persons concerned in joint stock speculations, with the exception of two specified companies, were subjected to heavy penalties. This Act was not repealed until 1825, and although during the greater part of its currency it was practically a dead letter, it none the less acted as a deterrent to joint stock enterprise. The next important advance was made under the Companies Act of 1855, which adopted the modern principle of limited liability, whereby the liability of any shareholder for the debts of the company was limited to the unpaid portion of the share capital held by him. Later Acts were consolidated under the Companies Act of 1929.

In 1943 the Cohen Committee was appointed by the President of the Board of Trade to consider what amendments were desirable in the Companies Act of 1929. Two years later, the Committee presented its report and most of its recommendations were embodied in the

Companies Act of 1947. The Companies Act of 1948 consolidates the Companies Act of 1929 and all but a few sections of the Companies Act of 1947.

ADVANTAGES OF THE JOINT STOCK COMPANY.—If it had not been for the development of companies with limited liability under the regulative provisions of the Companies Act, there would have been great difficulty in meeting the growing financial needs of modern enterprise, and without this assistance many of the great mechanical inventions by which the technique of industry has been transformed might have remained undeveloped. The importance of this form of enterprise may be gauged from the fact that there are nearly 300,000 companies (of which the majority are private companies) registered under the provisions of the Companies Acts. The popularity of this type of legal constitution may be ascribed to the existence of a number of important advantages, the chief of which will now be examined—

(1) Continuity of Existence. Upon the registration of a joint stock company under the provisions of the Companies Act, 1948, there is brought into existence a new legal entity entirely separate and distinct from the persons of the promoters by whose efforts it is created. It may own and dispose of property, enter into binding contracts, and incur fines and penalties for the acts of its servants. The independent legal status of the joint stock company was confirmed in the famous leading case in company law of *Salomon* v. *Salomon & Co.* (1897). Here it was held that even in the case of a so-called "one-man" company, i.e. where one person holds practically all the shares and the other shareholders have only one share each, the company is a separate entity in law from the principal shareholder. Neither does the relationship of principal and agent exist between the company and its shareholders making the latter liable to indemnify the company against the debts which it incurs. This separation of identity confers upon the company what Blackstone called a kind of legal immortality. In other words, although individual shareholders may die, the company still continues in existence, always provided, of course, that the number of members does not fall below the legal minimum (see page 82). It could be pointed out, however, that although the joint stock company possesses the *potentiality* for perpetual existence, it by no

means follows that this is realised, some 3,000 companies being liquidated every year.

In respect of its continuity of existence, the joint stock company differs essentially from the partnership. The Partnership Act, 1890, stipulates a number of circumstances in which a dissolution of partnership may take place, such as the death or bankruptcy of a partner, or in the absence of an agreed time for the continuance of the firm, upon notice of withdrawal being given by any partner. This arises from the fact that, in the case of a partnership firm, the law does not recognise the existence of the firm as a separate entity, but merely acknowledges the partners in their personal capacity. Hence, in addition to the ordinary risks of business, which all organisations alike must face, the partnership is much more vulnerable than the joint stock company to dissolution from within, and may be regarded as a much less stable form of enterprise.

(2) Limitation of Liability. The liability of the shareholders of a registered company is limited to the amount of the nominal value of the shares which they have acquired. Thus, if a person has purchased 100 shares of £1 each from a company and has paid 10s. per share, or £50 in all, he can be compelled to pay no more than the outstanding balance, i.e. £50, and upon payment his responsibility ceases. This limitation of liability again arises from the fact which we have already mentioned—the separate legal identity of the company. The company enters into contracts and deals with property in its own name so that its creditors have to look to the company for payment and not to the individual directors or shareholders. If the property of the company is insufficient to meet its commitments, the creditors have no right of action against the shareholders, that is, assuming no legal irregularity. Here again we have an important point of difference between the company and the partnership. The creditors of the partnership have a right of action against all or any of the partners, and may enforce the judgment not only against the partnership property, but also against the private possessions of the individual partners.

This limitation of liability of the members of a joint stock company has an important result in the stimulation of investments. Many people will be naturally reluctant to invest money in an enterprise which may involve them in unlimited liability in the event of adverse business conditions. This is particularly true of

the small investor who will probably hoard his savings rather than expose himself to such a risk.

(8) Transferability of Shares. A further device by the aid of which the joint stock company has stimulated investment is the transferable share certificate. As we have already pointed out, modern business enterprise requires the investment of large sums of capital in fixed and in circulating assets. Capital so invested, particularly in fixed assets, is difficult to realise except at a heavy loss and any attempt to do so must paralyse the activities of the business, or, at best, seriously impair their efficiency. Hence when once capital has been invested in a business, the investor must be prepared to leave it there unless he can find some one who is willing to buy his interest in the undertaking, in which case no disturbance takes place so far as the business itself is concerned. This problem of finding a buyer for an interest in a business undertaking is simplified by the device of the transferable *share certificate.* A person, on subscribing to the capital of a joint stock company does so by purchasing a number of shares of equal nominal value, the usual denomination being one pound. Subject to any restrictions imposed by the company, a shareholder possesses complete freedom to dispose of all or any of the shares which he has purchased, so that should he wish to realise his investment, he has only to find a buyer who will offer a satisfactory price and the transfer can take place upon the performance of the requisite legal formalities. This task of transfer would, even then, present considerable difficulty were it not for the fact that the way is made smoother by the existence of a market for dealing in such securities, namely, the Stock Exchange. Through the medium of this institution a price is fixed for a wide range of securities on the basis of the expert judgment of dealers, and the services of this market are available to the investor.

The transferable share saves the joint stock company from yet another of the difficulties associated with the partnership business. The right to restrict the transfer of shares, where it exists, is vested in the directors and in any case must be used with care, so that a member of a company can sell his shares without reference to the other shareholders. In the case of a partnership, however, a new partner cannot be introduced without the consent of all the other partners. The reason for this difference in the law is not far to seek. Membership of a company does not, of itself, confer any right to

interfere in the management, but in the case of a partnership, in the absence of special agreement, all partners have a right to share in the management of the business. It is only simple justice, therefore, that partners should be protected from the danger of having an unwanted co-partner thrust upon them. None-the-less, this circumstance raises difficulties if one member wishes to withdraw, and the remaining partners may be put to considerable embarrassment in buying out the retiring partner if they wish to continue the business.

(4) **Accumulation of Large Resources.** The foregoing considerations, particularly the limitation of liability and the possibility of transferring the ownership of shares, have served to stimulate the process of capital investment, particularly from the small investor. It has been shown by Mr. Hargreaves Parkinson[1] that in the case of the ordinary shares of an average British company with a large capital and an active market for its shares, approximately 40 per cent of the shareholders hold fewer than 100 shares each, whilst nearly 90 per cent hold fewer than 500 shares each. We are justified in concluding therefore that it is the small investor who provides the bulk of the finance by which "big business" is carried on at the present day. The large capital accumulations which are essential to the large businesses of the present day could never have been provided on the basis of a partnership arrangement. A limited number of men could never possess between them the capital resources necessary. By providing a means whereby a widespread appeal can be made to investors of all classes, the joint stock company overcomes the difficulty. Thus Imperial Chemical Industries, Ltd., has drawn its capital of over £260,000,000 from many thousands of shareholders.

(5) **Best Use of Economic Resources.** In theory, at all events, the joint stock company offers a possibility of turning the economic resources of a community to the best possible use. In a developed community we shall find a large amount of capital in the form of small savings seeking profitable investment, whilst at the same time there will be a limited number of men with exceptional business ability who can be trusted to make a success of a business enterprise. By the formation of a joint stock company an outlet for investment is provided, whilst the company, by employing the best talent available, is enabled to make the transaction a profitable one

[1] *Scientific Investment.*

THE LEGAL FOUNDATION
OF A JOINT STOCK COMPANY

EXTERNAL RELATIONSHIPS
governed by
MEMORANDUM OF ASSOCIATION

FORM

(1) Printed, written or typewritten.
(2) Stamped with 10s. deed stamp.
(3) Bearing Companies' Registration Fee Stamps.
(4) Signed by Subscribers.

CONTENTS

(1) Name Clause.
(2) Domicile.
(3) Objects Clause.
(4) Limitation of Liability.
(5) Capital Clause.
(6) Association Clause.

INTERNAL RELATIONSHIPS
governed by
ARTICLES OF ASSOCIATION

FORM

(1) Printed.
(2) Divided into numbered paragraphs.
(3) Stamped with 10s. deed stamp.
(4) Signed by each. Subscriber to the Memorandum.

CONTENTS

Shareholders

(1) Rights of different Classes.
(2) Meetings.
(3) Voting Powers.
(4) Calls on Shares.
(5) Powers of Forfeiture.
(6) Company's right of Lien.

Directors

(1) Number and Remuneration.
(2) Meetings.
(3) Powers and Duties.
(4) Qualification.
(5) Provisions for Vacation of Office.

Public

(1) Borrowing Powers.
(2) Accounts.
(3) Transfer of Shares.

for its shareholders. Through the joint stock company, capital and business ability may be linked together for the benefit both of the individual investor and the whole community.

REGISTRATION OF A COMPANY.—A joint stock company of the type which we are here considering will be formed for the purpose of carrying on some type of industrial or commercial activity by a group of persons known as the promoters. Although the work of the promoter is essential to the formation of the modern company, no statutory definition has been laid down, although a promoter has been judicially defined as "one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose." It is the promoters who conceive the project which is to form the business of the company and who enter into any preliminary negotiations which may be necessary. Thus, if property is to be taken over, they will arrange the terms of sale or possibly actually acquire the property on behalf of the company which is to be formed. It has been clearly established as the result of a large number of legal decisions that the promoters of a company stand in a special position of trust to the company which they are forming, and the principles of the law of agency and of trusteeship have been extended to this relationship. The promoters must make complete disclosure of their interest in the transaction, and must on no account make a secret profit at the expense of the company.

Before a company can come into existence as a legal entity it must be registered with the Registrar of Companies at Bush House. Hence when the preliminary matters have been settled and the way is clear for the flotation of the company, the promoters will proceed with the formalities of registration. These consist in the preparation and lodging of a number of documents with the Registrar and also the payment of certain stamp duties and fees. This process of registration is necessary for the protection of the investing public who may be asked to subscribe to the capital of the company and also for the protection of all other persons who may, sooner or later, enter into business relations with the new company. The documents which are lodged on registration give what is considered to be an essential minimum of information regarding the constitution and management of the company. When the documents have been registered at Bush House any member of the public, upon

SPECIMEN MEMORANDUM OF ASSOCIATION

The Companies Act, 1948

Company Limited by Shares

MEMORANDUM OF ASSOCIATION
of
THE ENTERPRISE ENGINEERING COMPANY, LIMITED

1. The name of the Company is "THE ENTERPRISE ENGINEERING COMPANY LIMITED."
2. The registered office of the Company will be situate in England.
3. The objects for which the Company is established are—
   (*a*) To conduct, enter into and carry on in a wholesale or retail capacity the business of manufacturers of and dealers in and merchants and factors of Radiators, Boilers, and all kinds of Heating Apparatus, China, Porcelain or Pottery Articles, and all accessories and goods used or dealt with in connection therewith.
   (*b*) To carry on business as ironmongers, turners, brassfounders, engineers, founders, smiths, machinists, tool-makers, metal workers, furnace designers and constructors, boilermakers, millwrights, iron and steel converters, metallurgists and electrical engineers, carpenters, joiners, wood-workers and cabinet makers, and to deal in (either wholesale or retail) all articles and things which are capable of being manufactured in such businesses.
   (*c*) To acquire, undertake and carry on the whole or any part of the business, property and liabilities of any company carrying on any business which the Company is authorised to carry on or possess, or which may seem to the Company capable of being conveniently carried on or calculated directly or indirectly to enhance the value of or render profitable any of the Company's property or rights or any property suitable for the purposes of the Company.
   (*d*) To enter into partnership or into any arrangement for sharing profits, union of interests, co-operation, joint adventure, reciprocal concession, or otherwise, with any company or person, or with any employees of the Company, including in such case if thought fit the conferring of a participation in the management or its directorate or with any company carrying on or engaged in any business or transaction capable of being conducted so directly or indirectly to benefit the Company, and to give to any company or person special rights or privileges in connection with or control over this Company, and in particular the right to nominate one or more directors of this Company. And to lend money to, guarantee the contracts of, or otherwise assist any such company, and to take or otherwise acquire shares or other securities of any such company, and to sell, hold, re-issue, with or without guarantee, or otherwise deal with the same.
   (*e*) To borrow or raise and receive the payment of money in such manner as the Company shall think fit and in particular by the issue of debentures or debenture stock, perpetual or otherwise charged upon all or any of the Company's property, including its uncalled capital, and to purchase, redeem or pay off any such securities.
   (*f*) To draw, make, accept, endorse, discount, execute, and issue promissory notes, bills of exchange, bills of lading, warrants, debentures, and other negotiable and transferable instruments.
   (*g*) To sell or dispose of the undertaking of the Company or any part thereof, for such consideration as the Company may think fit, and in particular for shares whether fully or partly paid up, debentures or securities of any other company, whether or not having objects altogether, or in part, similar to those of the Company, and to hold and retain any shares, debentures and securities so acquired.
   (*h*) To do all such things as are incidental or conducive to the attainment of any of the above-mentioned objects.
4. The liability of the members is limited by shares.
5. The capital of the Company is £1,000,000, divided into 1,000,000 shares of £1 each.

We, the several persons whose names and addresses are subscribed, are desirous of being formed into a Company in pursuance of this Memorandum of Association, and we respectively agree to take the number of shares in the capital of the Company set opposite to our respective names.

Names, Addresses, and Descriptions of Subscribers	Number of Shares Taken by each Subscriber
George Robinson, 10 Snow Hill, Newport, Engineer	*One*
Albert Brown, 109 Ninian Road, Cardiff, Independent	*One*
Frank Hall, 45 Wind Street, Swansea, Accountant	*One*
Robert Johnston, "Sunnyside," Rhiwbina, Cardiff, Engineer	*One*
Alfred Williams, 98 Queen Street, Cardiff, Solicitor	*One*
John J. Jones, 14 The Parade, Penarth, Clerk	*One*
James Jackson, 6 Dyvrig Street, Cardiff, Independent	*One*

Dated this *1st January*, 195—

Witness to all the above signatures,

William A. Harrison,
Principality Buildings,
Cardiff, Solicitor.

payment of a nominal fee, may inspect them, so that there is a presumption at law that every person dealing with the company is aware of their contents.

The following documents have to be filed upon registration—

(1) **Memorandum of Association.** This is the most important document connected with the company since it defines the constitution of the undertaking in its relation to the outside world. As will be seen from an examination of the abridged specimen on page 100, the Memorandum consists of six main clauses—

(*a*) THE NAME CLAUSE, which states the name of the company in full, the Companies Act providing that the name must end with the word "Limited" unless permission be obtained from the Board of Trade to omit this. A company may select any name it pleases, except that it may not register a name identical with that of a company already in existence, or so closely resembling it as to be calculated to deceive the public. For this purpose it must first seek Board of Trade consent to use the proposed name. This measure is designed to protect the goodwill of existing companies. In addition, the Companies Act prohibits the use of a number of words including Royal, Imperial, Municipal, Chartered, and Co-operative without the consent of the Board of Trade.

(*b*) SITUATION OF REGISTERED OFFICE. The second clause states what is known as the *domicile* of the company, i.e. the country in which the registered office is to be situated. For the purpose of company registration Wales is deemed to be part of England. Once the domicile has been selected it cannot be changed, but the company can move its registered office about within the country of registration. Thus, if a company is domiciled in England it could move its registered office from London to Cardiff or to Liverpool, but could not move to Edinburgh.

(*c*) OBJECTS CLAUSE. This states what the company may do and effectively defines its relationship with the outside world. A company may alter its objects clause by special resolution and confirmation by a Court of Law is no longer required. Dissentients may make application to the Court within 21 days provided they hold 15 per cent of the issued share capital or 15 per cent of the debentures. If no application to cancel the alteration is made to the Court, the company must forward to the Registrar of Companies a printed

copy of the altered Memorandum within 15 days. Any acts purporting to be done by the company but falling outside the objects clause are said to be *ultra vires* or "beyond the powers" of the company and, as such, are not binding upon it.

(*d*) LIABILITY CLAUSE. This is a simple statement to the effect that the liability of the members is limited. This limitation of liability may be either by shares or guarantee, but the usual presumption is that liability is limited by shares. In such circumstances the total possible liability to which any shareholder may be subjected is limited to the nominal value of his shares and, when these are fully paid up, his responsibility ceases.

(*e*) CAPITAL CLAUSE. This clause must state the amount of the capital with which the company proposes to be registered and the mode of its division into shares of fixed amount. The Companies Act imposes no regulation as to the absolute amount of capital of a company nor regarding the nominal value of the shares into which it is divided. The usual denomination of the shares of a company is £1, since this is a convenient amount for most classes of investors. The Companies Capital Duty of 10s. per cent is payable upon the capital as stated in this clause. The amount of the registered capital may be altered by special resolution and on payment of the additional duty, though a reduction of capital will be permitted only after a most careful inquiry into the circumstances which have occasioned it, and on the sanction of the Court.

(*f*) ASSOCIATION CLAUSE. This is the final clause of the Memorandum and takes the form of a declaration by the signatories that they are desirous of being formed into a company and that they are prepared to take up and pay for the number of shares set opposite their respective names. The Memorandum must bear the signatures of at least seven persons in the case of a public company and at least two in the case of a private company, whilst each must agree to take up not less than one share in the capital of the company.

(2) **Articles of Association.** This document contains the regulations which govern the internal management of the company as distinct from the Memorandum which controls its external relationships. The Articles must be signed by the signatories to the Memorandum. In the case of a public company, it is not essential that special Articles of Association should be drawn up, and if no Articles are registered the company is considered to have adopted a set of

model articles known as Table A, which are contained in the First Schedule of the Companies Act. This course is not open to a private company, however, since this type of undertaking must limit the number of its members to fifty, and restrict the right to transfer shares—matters which are inconsistent with Table A.

The alteration of the Articles of Association is a matter which rests purely with the shareholders of the company since the Articles are concerned merely with its domestic affairs. This power of alteration is limited by certain necessary restrictions. The company cannot alter its Articles in such a way as to contravene the powers conferred upon it by its Memorandum; neither can it do anything which is illegal under the Companies Act.

(3) **Statement of Nominal Capital.** In addition to the capital clause contained in the Memorandum of Association, a statement of nominal capital must also be registered showing the amount of the registered capital, that is, the same amount as shown in the Memorandum. It is this document that attracts Companies Capital Duty.

(4) **Statutory Declaration.** This is a declaration to the effect that all the requirements of the Companies Act, 1948, have been duly complied with, and is made either by a solicitor engaged in the formation of the company, or by a person named in the Articles as a secretary or director.

(5) **List of Persons Who Have Consented to Become Directors.** The company must, at the time of registering the Memorandum and Articles, lodge a list of persons who have consented to become directors. It should be noted that all public companies which were registered after 1st November, 1929, must have at least two directors. A company must have a secretary, and a sole director cannot also be secretary.

(6) **Consent to Act.** It is frequently the practice to name the first directors of a company in the Articles of Association, but no person named in this way is validly appointed until he has delivered a written consent to act to the Registrar. In the same way he may not be named in the Prospectus or Statement in Lieu of Prospectus as a director without complying with the same formality. Furthermore, each director must have either—

(*a*) Signed the Memorandum for his qualification shares; or

(*b*) Taken his qualification shares from the company and paid or agreed to pay for them; or

STAGES IN THE FORMATION OF A PUBLIC LIMITED COMPANY UNDER THE COMPANIES ACT, 1948

STAGE	LEGAL FORMALITIES	COMMENTS
I. Preliminary Work of Promotion.	(1) Draft Memorandum of Association. (2) Draft Articles of Association. (3) Prepare Preliminary Contracts. (4) Prepare Draft Underwriting Agreements. (5) Draft Prospectus.	At this stage, the Company, as a legal entity, has no existence, and the Promoters must undertake everything on their own responsibility. They will endeavour to enlist the necessary financial support against the time when the Company is floated.
II. Incorporation.	(1) Registration of— (a) Memorandum of Association. (b) Articles of Association. (c) Statement of Nominal Capital. (d) List of Persons who have consented to become Directors. (e) Written Consents to Act as Directors. (f) Declaration of Compliance with Requirements of the Act. (2) Notice of Situation of Registered Office (within 28 days of incorporation). (3) Payment of Stamp Duties and Fees. (4) Issue of Certificate of Incorporation.	The promoters complete the various documents and forward them, together with a cheque for the various stamp duties and fees to the Registrar of Companies at Bush House. When the Registrar has satisfied himself that the requirements of the law have been duly complied with, the Certificate of Incorporation is issued. At this stage the Company comes into existence as a legal entity, though, in the case of the Public Company, it is not as yet entitled to commence business.
III. Raising the Capital.	(1) First Board Meeting. (2) Adoption of Preliminary Contracts, etc. (3) Appointment of Bankers. (4) Application for Stock Exchange Quotation. (5) Registration of Prospectus. (6) Issue of Prospectus.	The Company must now proceed to appeal to the public for subscriptions to the capital, and for that purpose it must issue a prospectus which must first be delivered to the Registrar of Companies for registration.
IV. Issue of Shares.	(1) Receipt of Applications from Prospective Shareholders. (2) Allotment of Shares by Directors. (3) Posting Letters of Allotment. (4) Posting Letters of Regret. (5) Splitting Letters of Allotment. (6) Issue of Share Certificates (within 2 months after allotment). (7) Preparation of Register of Members.	At this stage the directors receive the applications for shares from the public and make the necessary allotments. Unsuccessful applicants are notified by a "Letter of Regret." A further instalment on the shares is usually payable on allotment.
V. Commencement of Business.	(1) Lodge Statutory Declaration in regard to— (a) Minimum Subscription. (b) Directors' Qualification Shares. (2) Issue of Certificate to Commence Business. (3) Issue of Statutory Report to Shareholders. (4) Holding of Statutory Meeting.	A declaration is filed with the Registrar to the effect that the Minimum Subscription has been subscribed and that the Directors have taken up and paid for their qualification shares. Upon the issue of the trading certificate, the Company is free to commence business.

(*c*) Signed and delivered to the Registrar an undertaking to take up and pay for his qualification shares; or

(*d*) Delivered to the Registrar a statutory declaration to the effect that a number of shares, not less than his qualification, are registered in his name.

(7) **Notice of Situation of Registered Office.** As we have already seen, the Memorandum contains a statement as to the domicile of the company, but makes no statement as to the exact location of the registered office. Notice of the situation of this office must be delivered to the Registrar within 28 days of the incorporation of the company, and within 28 days of any change in the address. As a rule this document is delivered on registration.

When these documents have been lodged and the necessary stamp duties and fees paid, the Registrar, after satisfying himself that everything is in order, will issue a *Certificate of Incorporation.* Upon the issue of this certificate the company comes into existence as a legal entity and, in the case of a private company or a guarantee company without share capital, may commence business. Once this certificate has been issued, the validity of the registration of the company cannot be called into question by any person. This again is but a common-sense protection for the commercial community, since the course of business would be rendered much more uncertain if it were possible, after a period of time had elapsed, to go back and cast doubts on the validity of the certificate of incorporation.

In the case of a public company, the issue of this certificate does not empower the undertaking to commence business. Such a company still has to obtain its capital from the public before it can commence business. A scheme of capitalisation will have to be drawn up to determine what sum of money the concern needs to make a successful start, and a decision made in the light of current market conditions as to the form which such capital issue should take. A Prospectus will be prepared to give full information concerning the share issue and the objects and previous trading results of the concern if it has previously existed in another form. This prospectus will state the minimum capital required for the company to commence operations, and it must subsequently be shown that this minimum capital has in fact been obtained.

RAISING THE CAPITAL.—Having registered the company at Bush House, the directors of a public company now set about

raising the capital which they require by issuing a Prospectus. This is an appeal to the public usually published in the form of a circular or a press advertisement, inviting them to subscribe to an issue of shares, full particulars of which are given. Before the Prospectus can be offered to the public, a copy must be delivered to the Registrar of Companies signed by every director or proposed director mentioned in it. Any report by an expert in a Prospectus must be accompanied by his written consent. Now, since the Prospectus is the means whereby members of the investing public are induced to subscribe to the share capital of the company, the Companies Act, 1948, lays down a number of requirements regarding its composition which are designed to check the activities of the unscrupulous. The drafters of the Prospectus are under the obligation of making complete disclosure of all material facts connected with the flotation of the company, i.e. all matters which might reasonably be expected to influence the decision of the average person to take shares in the company. In addition, the Act specifically names a list of matters which must be included.

The Prospectus may be issued to the public by the company through its bankers and any other medium by which publicity may be gained, or the whole business of issue may be given into the hands of an *Issuing House* which will deal with the whole of the technical details for a commission. In any case, the directors of a company cannot proceed with an issue of capital unless the amount of the Minimum Subscription has been applied for, and if the subscription falls short of this amount the money must be refunded. In order to avoid difficulties of this type an arrangement is entered into with underwriters that, in return for a stated commission, the underwriters will take up and pay for a certain number of shares if these are not subscribed by the public. The commission is, of course, payable whether the underwriter is called upon to take up the shares or not.

APPLICATION FOR SHARES.—The prospective shareholder who, on the strength of the prospectus has decided to apply for shares in the company, must fill up an application form on the lines of the specimen on page 107. This form, together with a cheque for the amount required upon application, will be forwarded to the company's bankers. The completion of this form constitutes an offer on the part of an applicant to take up and pay for the number of

SPECIMEN APPLICATION FORM

No............................

THE ENTERPRISE ENGINEERING COMPANY LIMITED

Issue of 750,000 Ordinary Shares of £1 each at 20s. 6d. per Share

FORM OF APPLICATION

To the Directors of

THE ENTERPRISE ENGINEERING COMPANY, LTD.,
37 Mount Stuart Square, Cardiff.

GENTLEMEN,

Having paid to your Bankers the sum of £....125............, being a deposit of 2s. 6d. per Share on application for ....1,000............ Ordinary Shares of £1 each of your Company (being 2s. per Share in respect of capital and 6d. premium), I/we apply for that number of Shares at 20s. 6d. per Share and request you to allot the same to me/us, and I/we hereby undertake and agree to accept such Shares or any less numbers that may be allotted to me/us, upon the terms of the Company's Prospectus, dated the 27th day of July, 19 . ., and subject to the Memorandum and Articles of Association of the Company, and I/we agree to pay the further instalments as provided by the said Prospectus, and I/we hereby authorise you to place my/our name(s) on the Register of Members of the Company as holder(s) of the said Shares.

Yours faithfully,

Usual Signature................*Wm. J. Smith*...................

PLEASE WRITE DISTINCTLY

Surname.. .... *Smith* ....

Christian Name or Names.........*William James*........

Address........210 *Newport Road*,.................................

............................*Cardiff* ....

Profession or Occupation............*Engineer* ....

Date.........*29th July* ...., 19 . .....

APPLICATIONS IN THE NAME OF A FIRM WILL NOT BE ACCEPTED.

Cheques should be made payable to "Midland Bank Limited, or Bearer," and crossed "& Co." If altered from "Order" to "Bearer," the alteration should be signed by the Drawer.

An acknowledgment will be forwarded in due course, either by Allotment Letter or return of the deposit.

shares stated or any smaller number that may be allotted to him by the directors. This offer is converted into a binding contract after the directors have posted their acceptance in the form of a *Letter of Allotment* to the shareholder. This document takes the form of a notification that a certain number of shares have been allotted and usually requires that a further instalment shall be paid within a stipulated time. If, however, the issue has been over-subscribed, that is, if applications have been received for a greater number of shares than are available, *Letters of Regret* are sent to the unsuccessful applicants and their application money is refunded at the same time. In the event of such an over-subscription, the policy pursued with regard to allotments is subject to some variation. The directors may eliminate all applications for less than a certain number of shares and allocate the remainder *pro rata*. Alternatively, if the business is such that a large number of shareholders has a publicity value, small applications may be allotted in full.

The directors will then make a second registration with the Registrar consisting of—

(*a*) A copy of the Prospectus.

(*b*) A statement that the minimum capital has been subscribed.

(*c*) A statement that the directors have paid for their shares in cash and to the same extent as members of the public.

(*d*) A further statutory declaration of compliance with the requirements of the Companies Act.

Upon receipt of these documents the Registrar will issue a certificate entitling the company to commence business, commonly known as a *Trading Certificate*, upon which the company may carry on its ordinary business.

THE CAPITAL OF A COMPANY.—From a legal standpoint, the capital of a joint stock company consists of that portion of the nominal capital as stated by the Memorandum of Association which has been issued to the public. Shares may be issued by a company either in exchange for cash or for value in any other form such as property or services. Thus, it frequently happens that when a new company acquires property such as an established business for example, the vendor receives the purchase price from the company partly or wholly in the form of fully paid-up shares. Again, the promoters of a company may receive payment for their services in

the form of shares. However, the bulk of the shares will usually be taken up and paid for in cash.

A company is under no compulsion to issue the whole of its nominal capital as stated in the Memorandum of Association. The amount which is actually issued to and taken up by the public is known as the *Subscribed Capital.* When shares are paid for in cash it is customary for the payments to be made by instalments, a certain proportion being payable when the shares are originally applied for, a further proportion when they are actually allotted, and the balance in one or more instalments. In this respect a company can make its own arrangements, the only reservation being that the amount payable on application must not be less than 5 per cent of the nominal value of the shares. The amount which has actually been paid is known as the *Paid-up Capital,* whilst the amount yet to be called up is termed the *Uncalled Capital.* It sometimes happens that shareholders do not pay instalments on the shares which they hold when these are called for by the company. These outstanding amounts are referred to as *Calls in Arrear.* See the diagram on page 110.

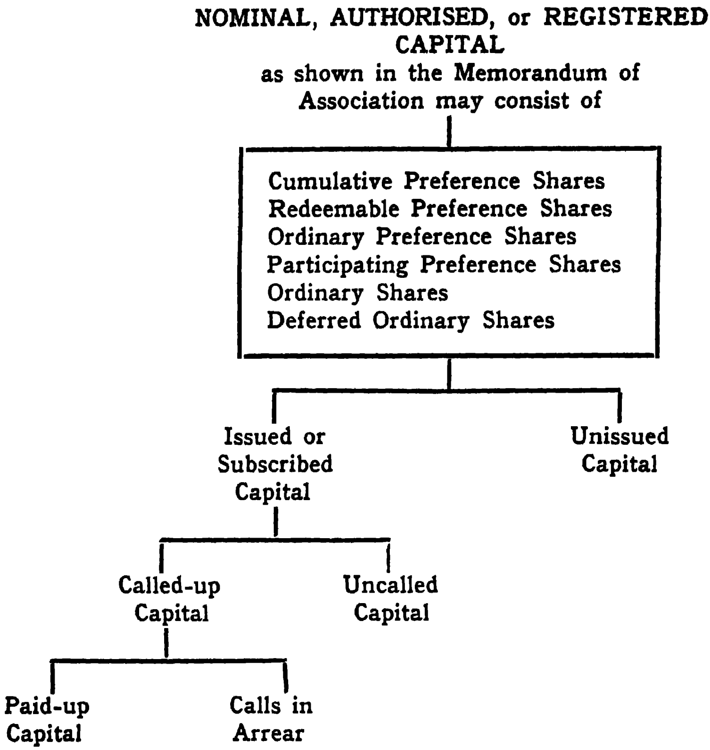
The issued capital of a company may be of a number of classes each of which carries its own distinctive rights. The chief are—

(1) **Ordinary Shares.** The holder of ordinary shares in a joint stock company might fittingly be described as a pioneer of industrial and commercial enterprise, since the greatest risks of the business usually fall upon his shoulders. He subscribes to the share capital of a business without having any special security for his investments other than his estimate of the inherent soundness of the concern, whilst he cannot claim any priority in the payment of dividends. Indeed, in both these respects, his rights are often subordinated to those of other classes of shareholders who may claim priority in the repayment of capital and will have priority to a share in the profits. In return for these disabilities, however, the ordinary shareholder usually stands to receive a relatively high return on his capital investment in the years of prosperity when business is good and earning power high. The ordinary share, therefore, may be regarded as an investment of a somewhat speculative type.

(2) **Preference Shares.** These shares when issued by a company confer a preferential claim to dividends upon their holders, and sometimes a priority in the repayment of capital in the event of

a winding up. Unlike the ordinary share, however, which has a right to dividends of any magnitude which the directors may care to declare provided that sufficient profits are earned to cover them,

THE CAPITAL OF A JOINT STOCK COMPANY



the preference share usually carries a right to a fixed rate of dividend which must be paid before the ordinary shareholders receive anything. The preferential shareholder, therefore, receives his dividend and the ordinary shareholder takes the residue so that the preference shareholder obtains no benefit in times of good trade. In some cases shares are created known as *participating preference shares* in which preference shareholders can take dividends at a fixed rate, then ordinary shareholders may receive dividends up to a stated maximum,

and any residue of profits which may still remain available for distribution will be shared between the two classes in some specified proportion. The preference share is not quite so speculative in character as the ordinary share, though it must be emphasised that in either case no dividend can be declared unless profits have been earned to cover it. In some cases a class of *cumulative preference shares* is issued so that if preference shareholders do not receive their full dividend in one year, the balance is carried forward and must be paid out of profits earned in subsequent years before any distribution can be made to other shareholders.

(3) **Deferred Shares.** It sometimes happens that if an existing business is converted into a public company, the vendors of the business wish to retain powers of control and rights to a large share of profits in their own hands. They therefore create a class of deferred shares which they hold themselves. These shares usually carry special voting powers in meetings of the company and their rights to a dividend are deferred to those of the ordinary shareholders. Thus, it may be laid down that the holders of ordinary shares shall possess certain restricted voting rights and also a right to dividends up to a maximum of, say, 20 per cent. All profits in excess of this amount shall be distributed amongst the deferred shareholders.

TRANSFER AND TRANSMISSION OF SHARES.—As already indicated, one of the principal advantages possessed by the investor in the modern public company lies in the marketable nature of the securities which he holds. One of the first steps taken by a newly-formed company will be to apply for a Stock Exchange quotation for its shares so that a market for them may be created. Any shareholder wishing to sell his holding must draw up a transfer deed on the lines of the specimen shown on page 112. This must be stamped at the rate of £1 per cent of the consideration passing, with varying amounts for fractions of £100. Every *transfer of shares* must be approved by the directors of the company, who usually reserve the right to reject transfers which they consider undesirable. When the transfer has been approved, the necessary alterations are made in the Register of Shareholders of the company and new share certificates are issued. Upon the death of a shareholder, the right to deal with his shares automatically is vested in his legal personal representative.

MANAGEMENT OF THE COMPANY.—The registration of a com-

SPECIMEN SHARE TRANSFER DEED

Certificate of the within mention 100 *Ordinary shares* forwarded to the Company's Offices by *William Arthur Robinson.*

William Arthur Robinson,
201 *Penylan Road,*
Cardiff,

in *consideration of the sum of *one hundred and fifty pounds*
paid by *Robert James Hardcastle,*
174 *Glebe Road,*
Bristol,

hereinafter called the Transferee,

Do hereby bargain, sell, assign and transfer to the said Transferee—
One hundred (100) *Ordinary Shares of One Pound each, fully paid, numbered* 375,001 *to* 375,100,

of and in the undertaking called
The Enterprise Engineering Company, Limited

To hold unto the said Transferee, *his* Executors, Administrators and Assigns, subject to the several conditions on which *I* held the same immediately before the execution hereof; and *he* the said Transferee , do hereby agree to accept and take the said *shares* subject to the conditions aforesaid.

As Witness our Hands and Seal, this *eleventh* day of *October*

In the Year of Our Lord One Thousand Nine Hundred and

Signed, sealed and delivered by the above-named

__*William Arthur Robinson*____in the Presence of

* Witness's
- Signature__*John Collins*________________
- Address_____55 *Cathedral Road, Cardiff*_____
- Occupation_______*Clerk* ________________

___*Wm. A. Robinson* ________ Seal

Signed, sealed and delivered by the above-named

__*Robert James Hardcastle*___in the Presence of

* Witness's
- Signature__*William Smith* ______________
- Address______172 *Glebe Road, Bristol*______
- Occupation_______*Clerk* ________________

___*Robert J. Hardcastle* _______ Seal

Signed, sealed and delivered by the above-named

____________________________in the Presence of

Witness's
- Signature ____________________________
- Address ______________________________
- Occupation ____________________________

______________________________ Seal

Signed, sealed and delivered by the above-named

____________________________in the Presence of

Witness's
- Signature ____________________________
- Address ______________________________
- Occupation ____________________________

______________________________ Seal

* The Consideration-money set forth in a Transfer may differ from that which the first Seller will receive, owing to sub-sales by the original Buyer; the Stamp Act requires that in such cases the Consideration-money paid by the Sub-purchaser shall be that inserted in the Deed, as regulating the *ad valorem* Duty. The following is the *Clause* in question—

"When a Person having contracted for the purchase of any property, but not having obtained a Conveyance thereof, contracts to sell the same to any other Person, and the property is, in consequence, conveyed immediately to the Sub-purchaser, the Conveyance is to be charged with *ad valorem* Duty in respect of the Consideration for the Sale by the Original Purchaser to the Sub-purchaser."—[33 & 34 Vict. Cap. 97, sec. 74, sub-sec. 3.]

When a Transfer is executed out of Great Britain it is recommended that the Signatures be attested by H.M. Consul or Vice-Consul, a Clergyman, Magistrate, Notary Public, or by some other Person holding a public position—as most Companies refuse to recognise Signatures not so attested.

* **A WIFE SHOULD NOT WITNESS HER HUSBAND'S SIGNATURE, NOR SHOULD HE WITNESS HERS**

pany under the provisions of the Companies Act, 1948, calls into existence a new legal entity, capable of carrying on business, and of owning and disposing of property. Yet, such an impersonal creation of law must act through some human intermediary, who, in practice, takes the form of the company director. It would be a matter of impossibility for the shareholders of a large public company to exercise their rights as proprietors and manage the company's affairs personally, so that it becomes necessary for them to elect a variable number of representatives who can act for them. In practice, the mode of appointment of such persons is almost invariably prescribed by the Articles of Association, but Section 176 of the Companies Act provides that every company registered on or after 1st November, 1929, must have at least two directors, unless it is a private company. Upon the formation of a new public company, it is customary to insert in the Articles the names of the persons who are to be appointed the first directors. Subsequent appointments are usually made annually by the company in general meetings. Thus, in theory at all events, the directors are responsible to the shareholders for their conduct of the company's affairs, and their actions are subject to a measure of criticism and control of shareholders' meetings. Such control can rarely be said to be very effective, however, since the majority of the shareholders of a large company never attend the annual meetings.

DIRECTORS.—The principles on which directors are selected vary widely from one concern to another, but in the past a considerable volume of criticism has been evoked against a number of common practices. Thus, there is the practice of selecting men of good social standing but with little or no knowledge of business to take seats on the board of directors. These are usually content to follow the lead of a dominating director, and "do not perform any function at all, but just sign where they are told to sign." [1] Occasionally such directors are appointed because of their ability to attract business to the company by reason of their influential connections. At other times they are appointed with the less laudable object of impressing the prospective shareholder with the standing of a new concern, and in such circumstances their appointment cannot be too strongly

[1] Evidence of Mr. H. E. Burgess, Senior Official Receiver, before the Company Law Amendment Committee, Cmd. 2657, Minutes of Evidence, Q. 479.

condemned. Cases have been far too frequent in which a director has lent his name to a company for what may be termed *window dressing* purposes, and has treated himself as thereby having given ample consideration for his remuneration, and as being absolved from any further effort towards promoting the welfare of the concern.

Moreover, so far as the duties of directors to the company are concerned, it has been clearly stated in the Courts that a director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings and at meetings of any committee of the board upon which he happens to be placed. So long as the provisions of the Articles of Association are observed, a director is justified in delegating duties to the paid officials of the company, and, in the absence of grounds for suspicion, is justified in trusting those officials. This, however, does not mean that his trust can be a blind one, for over-riding all else is the rule that he is bound to use fair and reasonable care and diligence in the discharge of his duties, and will be liable for negligence if he fails in this respect. With the exception of such powers as are vested in individuals or committees, the powers of control of directors can be exercised, as a general rule, only at a duly convened and properly constituted board meeting. A *board meeting* must be held in accordance with the principles laid down in the Articles, which may stipulate, for instance, that a meeting of the board shall be held on a specified day in each month. As a rule, however, the Board is convened as the requirements of business dictate. The following conditions must be observed—

(1) All persons entitled to be present at the meeting should have received proper notice and been given an opportunity to be present. The length of notice must be in accordance with the Articles and, in the absence of express instructions, must in any case be reasonable. Notice need not be given to a director who is abroad.

(2) The proper person must be in the chair. As a rule the Articles provide that the directors may elect a chairman of their meetings and determine the period for which he is to hold office.

(3) If the articles stipulate the minimum number of directors who must be present in order to transact business, then unless this number is present any resolutions passed are invalid. Directors must now retire on reaching the age of seventy.

MEETINGS.—Meetings of shareholders fall into a number of classes,

the first of which is the *Statutory Meeting*. This is usually the first meeting of the shareholders of a joint stock company, and must be held not less than one month nor more than three months from the date at which the company is entitled to commence business. This meeting is convened in order to afford the shareholders an opportunity for seeing what degree of success has attended the flotation of the company, and in order that any special matters requiring their approval may be laid before them. The *Annual General Meeting* is the one at which the routine business of the company is transacted. This must be held once a year, in addition to any other general meeting, and not more than fifteen months after the preceding annual general meeting. Should the company default, the Board of Trade may call or direct the calling of the meeting. This meeting deals with such matters as the retirement and re-election of directors and auditors, consideration of the annual accounts, and the declaration of dividends. Thirdly, there is the *Extraordinary General Meeting*, which may be held subject to the terms of the Articles at any time the directors think fit when it is desired to transact business of a special character. Further, the directors must, on the requisition of the holders of not less than one-tenth of the paid-up share capital, convene an extraordinary general meeting. If they fail to do so within twenty-one days, the requisitionists themselves may convene the meeting, any reasonable expenses being paid out of the funds of the company.

A shareholder may appoint any person to attend a general meeting as his proxy and vote on a poll. Proxies may be lodged up to forty-eight hours before the meeting. Directors must now send proxy forms to all shareholders and not to selected members only.

ACCOUNTS.—The books which have to be kept by a company registered under the Companies Act, 1948, may be grouped under three headings—

(1) Financial Books which are essential for recording the transactions of the company according to the principles of double entry. Although the Act does not specifically state that the accounts must be kept on double entry principles, the requirements are such that they can be adequately covered only in this way.

(2) Statutory Books which are mainly books of record dealing with the membership of the company or its obligations and charges. They include a Register of Members, a Register of Directors or

Managers, a Register of Directors' Shareholdings, a Register of Mortgages and Charges, Minute Books, and an Annual Summary of Capital.

(3) Auxiliary Books which are not prescribed by statute, and are kept for purposes of convenience to facilitate the work of the company administration.

Every member and debenture-holder must receive a copy of the balance sheet, profit and loss account, group accounts, if any, and auditors' reports not less than twenty-one days before the annual general meeting. These documents must also accompany the annual return to the Registrar.

AUDITORS.—The appointment of an auditor at each annual general meeting to hold office until the next meeting is compulsory upon every limited company, both public and private. Directors and officers of the company are not qualified for appointment, since it is obvious that such procedure would not afford the members an independent audit. Auditors must be members of professional bodies designated by the Board of Trade.

The duties of the auditor are threefold—

(1) He must examine the books of the company.

(2) He must satisfy himself so far as he can that the books disclose the true facts.

(3) He must report all material points to the shareholders. The auditor's report must now cover the balance sheet, the profit and loss account, group accounts and certain statements which are to be found in the Ninth Schedule.

The Companies Act provides that the auditors of a company shall be entitled to attend any general meeting of the company at which accounts examined and reported by them are laid before the company, and to make any statements or explanations they desire.

TEST PAPER

1. "In the field of economic organisation the development of the joint stock company is the most important constitutional development of the last century." Give a reasoned explanation as to why this should be the case.

2. With what limitations is a sole trader likely to meet as his business continues to expand? Explain how he may overcome these limitations by converting his business into a joint stock company.

3. What are the advantages, if any, of the joint stock company form of organisation as compared with the partnership?

4. What do you understand by a joint stock company? In what ways may a group of persons be incorporated according to English law? How does a corporation differ from a partnership?

5. The leading characteristic of capitalism can be put in the form of the proposition that "where risk lies there control lies also." How far is this statement true of the modern public limited company?

6. What is meant by an allotment of shares in a company? What statutory conditions must be fulfilled before an allotment becomes binding on the allottee of shares?

7. A company has a capital of £210,000 composed of £150,000 preference shares of £1 each, and 60,000 ordinary shares of £1 each. The preference shares are entitled to a dividend of 10 per cent per annum, and also to one-fourth of all surplus profits available for dividend after 20 per cent per annum has been paid on the ordinary shares; if the net profit for one year is £50,000, what will a shareholder receive who holds 3,500 preference shares?

8. The Cardiff Estate Company, Ltd., is formed to purchase a piece of land in Park Street, Cardiff, for the purpose of promoting a public company to run a dancing hall there. Frame a suitable objects clause.

9. Explain the following terms in connection with a joint stock company: (*a*) Memorandum of Association, (*b*) Articles of Association, (*c*) Prospectus, (*d*) The minimum subscription, (*e*) Authorised capital, (*f*) Subscribed capital, (*g*) Issued capital, (*h*) Uncalled capital, (*i*) Reserve capital, (*j*) Calls in arrear, (*k*) Forfeited shares, (*l*) Directors' Minute Book.

10. What in your opinion are the principal functions of the Board of Directors and the Managing Director of a company?

11. Enumerate the different types of shares which a company may issue, with brief details of each type.

CHAPTER XII

Organisation and Management of a Business

The term "*organisation*" suggests a certain amount of calculated method and arrangement with a view to the production of better results than could otherwise be obtained.

The term "*business*" may be regarded as any form of activity connected with the making of profits. The organisation of business, therefore, has reference to a scheme of assigning duties upon some definite basis to persons engaged in a particular undertaking.

NATURE OF ORGANISATION.—The process of organisation is by no means a simple one, for it requires a high degree of skill to separate the work into parts and to allot each part to persons able to perform it. There is also the further difficulty of arranging for a supply of every kind of labour required ready to perform all the duties of any particular class, as and when the need arises. Moreover, the scheme of organisation must be so arranged as to find full employment for each class of labour.

One is apt to think of organisation, in connection with business affairs, as something analogous to machinery, a well-organised business being spoken of as running as "smooth as a machine." This seems to imply that a scheme is thought out in advance, and, when once it is put into operation, it will work almost automatically. The idea that a business will work automatically, however, is erroneous, and when once a business is organised, it cannot afterwards be left to run by itself. The guiding hand and, still more, the guiding brain of the entrepreneur or organiser must always be there to direct it, and must be ready to formulate new plans where the original scheme fails to apply.

The term "organisation" is sometimes so used as to imply that all the thinking necessary for the execution of the work is concentrated in the brain of the organiser, and that matters are so arranged that subordinates have simply to do what they are told. This view is rather over-strained, however, for almost every kind of work performed by human beings requires some amount of attention, or it would probably be executed entirely by machinery. Even

if the thinking could be concentrated in one or a very limited number of individuals, there still remains the work of carrying out the programme thought out by the organisers, and this rests with the subordinates. It is, therefore, the organiser's duty not only to formulate a *scheme of organisation*, but also to see that the scheme is carried out ; and this is a vastly different matter. It is one thing to give instructions, and another to get the instructions carried out.

The faculty of getting one's instructions carried out is, primarily, a problem in psychology, and is one of the most important factors in successful organisation. The person whose duty it is to get the work done has to consider the material with which he is dealing. He has to consider the minds of those who are really to do the work, and then appeal to them so as to get it done.

One of the most difficult matters in connection with every complicated organisation is to arrange that all the various units of which it is composed shall work together so as to produce a definite result in the desired direction. Definite lines should be established upon which everybody is tending to work, with a view to avoid overlapping, and so to prevent the enormous waste of effort which must necessarily exist where there is a lack of understanding among all concerned.

TESTS OF SOUND ORGANISATION.—Whether an organisation be sound or unsound depends upon the efficiency with which it achieves the ultimate object of the whole enterprise. Organisation is not an end in itself; its purpose is to facilitate the task of achieving other goals. The following may be specified as the criteria of a sound organisation—

(1) **Ease of Execution.** The primary test of organisation is the degree to which it enables work to be executed economically and easily. A poor organisation is one in which the execution of work is unnecessarily complicated. In a sound organisation every essential activity is initiated and carried through with the minimum of trouble and the maximum of effect, taking into account all whose duties compel them to take a share in the activity.

(2) **Balance.** A sound organisation is one in which each branch of the business is equally effective, and is organised on a plan which conforms to the whole scheme. This may be called "organisation balance." If one unit of an organisation be well planned and one

poorly planned, the net result is an unsound organisation. Furthermore, if one unit be well organised for its own internal working, but be inadequately adjusted to other units, the result must again be unsound. It will be clear, therefore, that the effective organisation of a large concern, divided into many units, implies that every unit, whether it be a large or a small one, must be organised on the same principles.

(3) **Co-ordination.** A sound organisation is one which permits the full co-ordination of every branch, so that the performance of the work of each unit is economically related to the work of other allied units, and the whole complies with the requirements of the main policies of the business. To ensure this, the chief executive must hold within his own grasp the decision as to how the organisation shall be built up, so that it may regulate every extension and determine every change in the light of the plan which he is pursuing for the whole enterprise.

(4) **Capacity for Expansion.** A sound organisation is one which places the enterprise in a position to grow and expand, without dislocation, despite changes in the personnel or methods. An ideal organisation, if it is to be stable and secure, must provide for such contingencies. It is short-sighted to plan an organisation to fit the personnel, who may happen, at any given moment, to form the staff of a business.

(5) **Use of Labour Power.** A sound organisation is one which makes the fullest use of the available human power, to the satisfaction of the individuals comprising the organisation, and for their highest efficiency in operation. The art of organisation is to locate human beings in the structure so that each consistently contributes what is required of him towards the conduct of the whole undertaking. The organiser must recognise that men must be given complete jobs, carefully defined, if they are to feel a full sense of responsibility.

FACULTIES OF BUSINESS ADMINISTRATION.—The term "administration" is commonly used to describe in the most general way the whole of the activities involved in the control or direction of a business or similar enterprise. The conduct of a modern business, however, requires the exercise of many varied types of work, corresponding to different kinds of skill, and representing various techniques. Organisation consists of a combination of work-functions

with human faculties. Organisation, in fact, not only determines the nature of the work which a man is to perform, but also the faculty he is to exercise in that work. Thus, both the sales manager and the commercial traveller are concerned with the function of sales distribution, but the former usually exercises determinative or advisory faculties, whereas the latter employs mainly the faculty of execution.

FACULTIES REQUIRED IN BUSINESS ADMINISTRATION

Faculty	Description of Personnel	Duties
Determinative	Board of Directors Managing Director	Determination of policy.
Administrative	General Manager Secretary Group Managers	General application of policy. Co-ordination between functions. Control of executive.
Executive	Departmental Managers Foremen Overseers	Departmental supervision and local co-ordination of function. Immediate supervision of work.
Operative	Factory Operatives Clerks Labourers Apprentices	Manufacturing and functional operations.
Consultative	Legal advisers Consulting Engineers Auditors Advertising Agencies	Specialised advice.

In every business undertaking, according to Sheldon,[1] the following faculties may be distinguished, though they may not be employed by separate persons—

(1) *Determinative Faculties.* It is impossible to consider the subject of organisation apart from the objectives which the particular enterprise aims to achieve. Before an organisation can be designed effectively, these objectives must be determined and defined. In other words, the business must have a "policy," that is, a scientifically determined scheme, defining these objectives and governing the methods to be adopted in pursuit of them. The responsibility for the determination of policy lies with those who exercise the direction of the business. Thus in a joint-stock company it is the duty of the board of directors to exercise this faculty.

(2) *Administrative Faculties.* Under this heading we may place

[1] *Philosophy of Management* (Pitman).

the faculties which control the general application of the business policy. The management of a modern business comprises many different activities, and, as a business grows, the complexity increases. If a general policy is to be carried out effectively and economically, it becomes essential that means should be established for the co-ordination of all these activities. Buying must be made to link up with manufacturing, manufacturing with selling, selling with advertising, so that the whole force of these various branches may be brought to bear with the maximum of effect and the minimum of waste. The highest co-ordinating position is that normally held by a general manager or managing director. This position, by whatever name it may be known, stands midway between the board acting in a determinative capacity, and the management.

(3) *Executive Faculties.* Under this heading fall the broad group ot activities which is usually termed management—the task, in general terms, of carrying out the policies of the business and of controlling and supervising the available means to that end. It includes all those who, in any degree, hold responsibility in the organisation—those who are usually designated as managers, foremen, supervisors, or technicians. They are executive in the sense that they are responsible for the manufacture of the firm's products, their sale to customers, the purchase of the necessary material, the advertising of the goods, and the keeping of the books. They execute these activities on the lines laid down for the general conduct of the business and exercise control and supervision by means of the organisation provided.

(4) *Operative Faculties.* This is the basic part of the industrial structure which is performed by the group we loosely call labour—the manual and mechanical work involved in manufacturing and distributing goods. This faculty is that which actually performs the task and applies the skill to actual operations.

(5) *Consultative Faculties.* Running through these grades comes the faculty known as Consultative.. This faculty may be provided by specially qualified individuals, whether of the staff or from outside, or by the combination of individuals in committees. It is the faculty provided by works councils, inter-departmental committees, and the many conferences and meetings which form so distinctive a feature of modern organisations.

MANAGEMENT OF A BUSINESS.—Management includes the work

of carrying out the policies of the business and of controlling the available means to that end. The members of the managerial staff must control production, keep accounts, and maintain records and statistics of many varieties. They must purchase what is required by way of raw materials, plant and machinery, and devote attention to business research.

One of the results of the growth in size of organisations has been the development of many levels of authority and control between the person on the factory floor or at the office desk who is doing a job and the top management where the power to alter systems, methods and policies lies. It has often led to the criticism that whereas in the smaller unit the proprietor often knows all of his employees by name and sees them at work and knows their personal problems and circumstances, in the large unit the individual worker is a stranger to top management and never has a chance to speak to anyone above the immediate foreman or department head level. This gives rise to the possibility of grievances arising and never being aired to those who are best in a position to remedy them. To combat this tendency most large units have established Personnel departments and Consultative Committees through which employees will have the chance to air grievances to the higher levels of management, and whose functional job it is to ensure that employees are satisfied with the treatment they receive and remain loyal to the firm. House magazines and sports and welfare facilities have played a large part in making people feel that they are members of a team and not mere ciphers who are paid to work for a certain number of hours each week.

It is becoming increasingly realised in these days of large units and full employment that much is to be gained from a contented staff who are made to feel that they "belong" in the organisation. The ability to get men to work efficiently together is not purely one of technical knowledge, and the good manager must also be a leader with a good human approach to his subordinates. Employees have a right to know what the firm is doing, what its future prospects and possible policy developments are, and many firms who have invited employees to serve on joint committees of workers and managements where production, organisation and welfare problems can be discussed, or to contribute to "suggestion schemes" for better working, have found considerable benefits emerging from the treatment of employees as human beings and not mere "hands."

TEST PAPER

1. What do you understand by the "organisation of business"?

2. Outline a scheme for the general organisation of any business with which you are acquainted, from the principal or principals down through sectional managers to the general staff.

3. What are the principal aims of business organisation? What tests should be applied to ascertain whether a given organisation is satisfactory?

4. How does the large-scale unit endeavour to overcome the lack of contact between employees and top managers?

CHAPTER XIII

THE MODERN OFFICE

THE office is the administrative centre of a business. Here the accounting and statistical controls on what is happening in all parts of the business are centred. Through the office flow the directives and instructions which ensure that the policy decided upon by the Board of Directors is observed by all departments and sections, and it is the office which is responsible for making the buying and selling contracts and the external relations of the business with its suppliers, customers and governmental, trade and commercial contacts.

Efficient administration in the office is as important to a modern business as is efficiency on the factory or workshop floor. In the past much attention has been paid to increasing the efficiency of productive processes, but all too often the office was allowed to grow haphazardly and without proper planning, job definition, or the supply of appropriate mechanical aids. In recent years, when there has been so much attention paid to productivity, it has been realised that scientific planning, work study and appropriate mechanisation have their place in the office also.

FUNCTIONS OF THE OFFICE.—The office is responsible for the discharge of the following functions—

(1) **Correspondence and Records.** From the office all the correspondence in connection with orders, contracts and outside relations are conducted. All of this paper work gives rise to the need for files and records of all sorts. Files of correspondence, duplicate invoices, receipts and vouchers must be kept long enough to satisfy the requirements of audit checks and the possibility of legal action arising on contracts made, which may call for reference back to the detailed arrangements. If the firm is a joint-stock company, a Register of Members must be kept to show who owns the various shares issued, and this register must be kept up to date as transfers of shares to new owners following sale and purchase on the Stock Exchange are registered. Minutes of Board and Committee meetings must also be recorded and preserved for reference, and there will normally be a large amount of inter-departmental notes and memoranda.

(2) **Accounting.** The importance of accounting records has increased considerably in recent decades as cost factors have become the principal index of planning and control. At the same time the importance of the Accountant has grown, and he is now frequently found at top executive or even policy-making level. Financial accounting, which records the expenses, revenues, assets and liabilities of the business, continues to be the basic form of accounting records. But from these records one can normally obtain a total profit or loss figure only for a period which is not detailed enough for the close control now necessary. In addition these records are historical ones, and if cost or expense trends have taken an unfavourable path it is only after some damage has already been done that financial accounts will show the position.

Most firms which manufacture or sell a number of different articles or which need to estimate for future work to be done have therefore added cost accounting to their basic financial records. In this system the direct material and labour costs going into each article made, or each process performed or each batch resulting from a given quantity of raw material, are traced through to the article, process or batch to which they are attributable. Overhead (or indirect) expenses are split on some arbitrary basis over the same productive units so that a total unit cost can be assessed. On the basis of a certain experience of these records, standard costs (i.e. what each job or process should cost) can be worked out, and the continuing records of actual cost can then be frequently compared with standards to detect any divergencies at the earliest possible moment.

In many businesses too, the accounting records of the past are now projected forward into the future in the form of a target of production and a planned achievement of that target through a given period. This is known as Budgetary Control. Starting from a Sales Forecast of potential sales and revenues for the given future period, this forecast is, after consideration of productive capacity, future policy, and the general economic outlook, modelled into a Sales Budget—the target of production and sales at which the firm is to aim. Once this target has been decided upon it is possible to preplan the raw materials, labour, machines and capital requirements which will arise. The even flow of work through the various departments and sections and the cash requirements and availabilities can be planned, and the whole functioning of the business during the

budget period can be foreseen. Actual performance can then be compared at frequent intervals to ensure that the planned target is achieved. It is, of course, necessary to keep the target under review as changing economic circumstances may force a revisal of the plans during the budget period.

(3) **Statistics.** Accounting data and information concerning sales, orders, stocks and a variety of other matters must be reported to top management as the basic facts upon which their policy decisions are to be made. These form the subject of graphs, tables and statements which are extracted and presented in statistical forms to the appropriate officials whose responsibilities for control demand regular reports. These statistics will reveal trends and variations through which control can be made effective. With so much detail to be supervised it is the divergencies from normal or expected patterns which must be detected quickly and acted upon if effective control is to be maintained.

(4) **Administration.** Apart from the above major areas of general activity for which most offices are responsible, the office is the administrative centre of the business. Through it the policy decisions of the proprietors of the business must be interpreted into instructions to the executives responsible for the various specialist functions in the production and commercial departments, and co-ordination of the efforts of all of these specialists to ensure achievement of the overall plans must be ensured. It is the centre through which these specialists will requisition the materials, man-power, information and assistance they need in order to carry out their part of the work, and it is the repository of the records which result.

MECHANISATION IN THE OFFICE.—The telephone (internal and external systems) and the typewriter are forms of mechanisation which have been present in the office for many years. But recent years have seen many more forms of mechanisation of office work coming into widespread use.

For handling mail there are letter-opening and letter-sealing machines and franking machines for stamping large quantities of mail.

Disc, tape or wire recording machines are available for the dictation of letters and reports, and while the principal executives of a business still retain their individual secretaries more and more of the reports and letters produced by other members of staff are recorded and then typed by "pool" typists from the records made.

Numerous aids to filing and records are available. Files may be classified alphabetically, numerically or regionally, and by means of tabs to the files or special arrangement the whole range may be made visible so that any file required may be quickly selected.

Continous stationery may be used for the reproduction of successive typewritten documents without the trouble of removing and replacing paper constantly, and "no carbon" paper is now available to give duplicate copies without interleaving sheets of carbon paper. Addressing machines, using either plates or stencils, are available for the recording of names, addresses and other information which has constantly to be repeated on a firm's records.

For the copying of documents there are stencil and spirit duplicators, and photo-copying machines, and firms which have a very large volume of records to keep can reduce them to microfilms and use a special reading machine to refer to particular records when they are wanted. Some very large concerns which have centralised their records and have many branches at which inspection of the records may be necessary are even using closed-circuit television to inspect the records exhibited at the central storage unit.

In the accounting field, calculating and adding machines and typewriters to which calculation boxes have been added are available. As information is typed or listed by key depressions the machine will record and automatically print additions, subtractions, multiplications and divisions.

Powers-Samas or Hollerith punched-card systems can be adapted to the requirements of various firms and processes so as to record basic data, verify and sort information, and print out a variety of information extracted from the cards which have been fed into the machines.

Electronic computers fed with information recorded on punched cards or tape are now capable of storing the information fed in and permitting the selection of any combination of information available from those records.

From these remarks it will be obvious that a very wide range of mechanical aids are now available in office work. It is still true, however, that in the majority of small offices little more than the original telephones and typewriters and possibly a duplicator will be available. But as the size of the office and the complications of its records increase, a greater range of aids will be found. Only the very largest

offices can hope to make profitable use of an electronic computer or full punched-card system. They are extremely costly and are capable of working so quickly that they will not be economically employed unless they can be fully utilised. Constant development is taking place and smaller machines which will be economical to use in medium-sized offices will almost certainly be available before long.

It is extremely important in contemplating the fuller mechanisation of an office to make sure that the system and machines to be used are adapted to the requirements of the office and not vice versa.

These developments are bound to bring in their train extensive alterations in the type and form of records kept and the functions of the clerks employed in the office. Machine calculations will cut out much of the slow, plodding, repetitive routine in which many clerks have in the past been engaged. Apart from the mechanics required to maintain and overhaul the machines, special clerks who understand the capabilities and to some extent the workings of the machines will be required to "programme" their work. These machines have been referred to as "mechanical brains" but, wonderful though they may be, they are no match for the human brain and are not capable of independent thought. What they can do is to make calculations or assess results from a body of information fed into them much more rapidly than the human brain could do it, but it still requires the clerical worker to feed it with the information it needs to do its work and to instruct it precisely as to what it is to do with that information.

In addition, there is no point in having such statistical information supplied in detail and at speed if use is not to be made of the information as soon as it is available. This calls for executive skill in putting the information to immediate and profitable use.

TEST PAPER

1. Outline the main functions common to all offices.
2. Why has the accounting function become more important in the past fifty years?
3. What developments have taken place in accounting in order to meet the requirements of present-day management?
4. What is "budgetary control?"
5. List some types of machinery to be found in modern offices, and describe their functions.

CHAPTER XIV

AGENTS

WHEN commercial transactions embrace a more extended and larger sphere of operations, the clerical staff and assistants of the business are insufficient to cope with the work involved, so that it is usual to appoint agents such as brokers, commission agents, shipping agents, warehousemen, forwarding agents, etc.

A **Mercantile Agent** means an agent having in the customary course of his business as such agent, authority—

(*a*) To sell goods, or

(*b*) To consign goods for the purpose of sale, or

(*c*) To buy goods, or

(*d*) To raise money on the security of goods.

Every person capable of contracting may appoint an agent to contract for him. It is not necessary that an agent should be capable of contracting in his or her own right in order to bind the principal. The nature and authority of an agent is defined in expressed terms, or implied from circumstances and conduct. Agents may be distinguished as—

(1) GENERAL AGENTS. These consist of brokers, factors, commission agents, managers, etc., and all persons employed in business or filling positions of a general kind, the extent of authority being apparent from the nature of the positions.

(2) PARTICULAR OR SPECIAL AGENTS. These denote persons appointed for a special or particular appointment.

A general agent has, in relation to third parties, full apparent authority due to his employment or position. The principal is bound by all his acts within the authority usually conferred, notwithstanding that—

(*a*) the principal has never held him out as being his agent ; or

(*b*) he has imposed special restrictive limits not known to the other party.

FACTORS.—A factor is a mercantile agent whose ordinary business is to sell goods with the possession or control of which he is entrusted by the principal. Hence a factor has implied authority—

(1) To sell in his own name.

(2) To sell at such time and prices as he thinks best for the principal.

(3) To sell upon the usual terms of credit.

(4) To receive payment of the price and give a good discharge to the buyer.

Any private instructions restrictive of the apparent authority due to his character of factor do not affect his ordinary transactions unless they are unsatisfactory to the other contracting party. Under the common law a factor could not himself pledge the goods which came into his possession. But according to the Factors Act, 1889, where a mercantile agent, including a factor, is in possession of goods or documents of title, any sale, pledge, or other disposition of goods made by him when acting in the ordinary course of business will be as valid as if he were expressly authorised by the owner to make the same, providing he acts in good faith.

BROKERS.—A broker is an agent whose ordinary course of business is to negotiate and make contracts for the sale or purchase of goods. Hence a broker is primarily an agent to establish privity of contract between two parties, e.g. an intending seller and an intending buyer of goods. Where a broker is acting as an agent for sale, he differs from a factor in that—

(1) A factor is entrusted with the possession of the goods he is employed to sell, whereas a broker is not.

(2) A factor has authority to act in his own name and to sue in his own name on the contract made by him, whereas the broker has no such authority.

(3) A factor has authority to receive payments and to give a good discharge to the buyer for goods sold by him, whereas the broker has not.

(4) A factor has a lien on goods in his possession, whereas a broker in ordinary cases has not. But there are two exceptions—

A. INSURANCE BROKERS have a lien on all policies of insurance effected by them in their own names and for all premiums paid or payable by them to the underwriters with whom the policies are effected.

B. STOCKBROKERS have a lien on all moneys and securities of their customers which have come into their hands in the ordinary course of business for whatever balance may be due to them.

When a broker makes a contract he puts the terms of the contract

into writing and delivers to each party a copy signed by him. The copy delivered to the seller is called the sold note and the copy delivered to the buyer is called the bought note.

According to the scope of their operations, the following classes of brokers are to be distinguished—

A. PRODUCE BROKERS occupy themselves with the negotiation of the purchase and sale of raw materials and commodities. Sometimes a public auctioneer is employed to effect a sale.

In many places, particularly in the large commercial centres and seaports, specialisation is carried to a very high degree, particular brokers being employed for each different class of produce. Thus there are tea, coffee, indigo, wool, yarn, timber brokers, etc.

B. STOCK AND SHARE BROKERS are concerned with the purchase and sale of Government securities, stocks and shares.

C. SHIPBROKERS are a class of agents who transact business connected with ships, such as negotiating charters, procuring cargo, and buying and selling ships.

D. INSURANCE BROKERS are occupied largely with the negotiation of marine insurance but also effect all other forms of insurance. They place risks at Lloyd's or with an insurance company for and on behalf of the owner of the ship, cargo, or property.

COMMISSION AGENTS.—A commission agent is a person employed, not to establish privity of contract between the employer and the third party, but to buy or sell goods for the employer on the best possible terms, receiving a commission for his exertions, e.g. where X, a merchant in Calcutta, agrees with Y, a commission agent in Manchester, that Y shall endeavour to procure a certain amount of calico, and when procured sell it to X, receiving not only the price at which the calico was bought, but a commission at, say, 5 per cent on the price as a reward for his exertions in procuring the calico. The duty of a commission agent who is employed to buy goods for a principal is twofold—

(i) To procure the goods required by his principal as cheaply as possible.

(ii) To charge the principal with the actual cost of the goods and the commission agreed upon and nothing more.

The commission agent engaged in the foreign trade acts in his own name, but for the account of either the foreign buyer or importer or on behalf of the home manufacturer. He must have a

special knowledge of the goods in which he deals; and must keep in close touch with the movements of their prices and with any alterations which take place in the process of their production. The primary object of the commission agent is to obtain orders from foreign buyers and then to pass them on in his own name to the home manufacturers. Moreover he has to supervise the execution of these orders and bring them to a satisfactory conclusion. In his dealings with the manufacturer, the commission agent acts in the interests of his principal, and insists on the goods being made according to sample, and on the delivery being effected by the date arranged. He also undertakes the work connected with the dispatch of the goods, such as the arrangements with the shipowner, the preparation of the bills of lading, the procuring of the Customs documents and the effecting of the insurance.

A DEL CREDERE AGENT is employed to sell the goods of his principal and, in consideration of a higher remuneration than is usually paid to agents, guarantees the solvency of his customer. In some trades a *del credere* commission is annexed to the employment of the agent by the usage of the trade, and therefore the contract need not be in writing.

FORWARDING AGENTS are persons employed to collect and deliver goods on behalf of others.

The merchant usually utilises the services of the forwarding agent in the dispatch of his goods. This is necessary especially in the consignment of goods across the sea, as the shipping companies do not hold themselves responsible for the conveyance of goods from the railway to the quay. The forwarding agent is also indispensable to the home trader who is in receipt of his supplies from abroad. It is his duty to be at the port of importation to receive delivery of the goods and to examine their quantity and quality, and to attend to either their warehousing or their onward transmission. Apart from these circumstances, it is almost always advantageous to the merchant to engage the services of the forwarding agent, because—

(1) The forwarding agent can forward separate parcels cheaper than the railway. He collects the various packages addressed to the same town or district from the different consignors into one consignment, and is thus enabled to avail himself of lower rates.

(2) Special privileges are usually granted by the railway to

forwarding agents so that it is often more economical for the public to deal with the latter than directly with the railway.

UNDERWRITERS undertake insurance risks at Lloyd's. One particular aspect of their work connected with the formation of joint-stock companies is that, in return for a certain commission, they will undertake that if the public do not take up shares in a company that is being floated, they themselves will take up and pay for a certain number of the shares. They are appointed by the company promoter. According to the Companies Act, 1948, a company may lawfully pay a commission to an underwriter in consideration of his subscribing or agreeing to subscribe whether absolutely or conditionally for any shares in the company provided—

(*a*) The proposed payment does not exceed the amount or rate authorised by the Articles of Association or 10 per cent of the price at which the shares are issued, whichever is the less; and

(*b*) The payment and its amount or rate is disclosed in the prospectus or in the statement in lieu of prospectus.

AUCTIONEERS are agents for both the buyer and the seller, although it is the seller who usually pays their commission. Where an auctioneer advertises a sale by auction "without reserve" he has implied authority and is indeed bound to sell to the highest bidder. Where he is in possession of the goods for the purpose of their sale by auction, he has a lien upon them for his charges. If the sale is subject to a reserve, this means that the seller has established a minimum price below which the auctioneer is not authorised to sell.

MANUFACTURERS' AGENT.—This type of agent is one who represents a number of manufacturers in a particular district. As a rule, he is given an exclusive agency for his area. He carries on business on his own account and on a commission basis.

WAREHOUSERS are persons acting in the capacity of agents, whose business it is to receive goods for the purpose of storage, for which they make a charge.

Warehousing consists in putting commodities in a place of safe keeping until such a time as the market or the consumer can use them. Storage has always been recognised as a fundamental economic service in the smoothing out of supplies, the object being to adjust supplies to the buyer's needs so that price levels are kept steady and even.

A warehouseman is bound to exercise reasonable diligence in preserving the goods, and has a lien on the goods until his charges are paid, i.e. he can retain the goods until he receives payment for warehousing them.

TEST PAPER

1. What is a Mercantile Agent?
2. What are the different classes of agents?
3. Distinguish a factor from a broker.
4. Enumerate the different kinds of brokers, and explain the function of each.
5. State clearly the duties of a Commission Agent.
6. What is a "Del Credere" commission? Explain what benefit accrues to the merchant through its payment.
7. Why do merchants engage forwarding agents to collect or deliver their goods?
8. Under what conditions may a company pay a commission to an underwriter?
9. For which party does an auctioneer act as agent, and who pays his commission?
10. What classes of persons are entitled to a *lien* on goods in their possession?

CHAPTER XV

Methods of Remuneration

Remuneration usually takes the form of a monetary payment in consideration of services rendered, but it must not be overlooked that the monetary consideration in itself is of little use to anyone, and that the real benefit received by the worker employed is represented by the purchasing power of the money received. From his point of view, therefore, fluctuations in the purchasing power of money will materially affect the problem as to whether he is or is not satisfied with an existing bargain. From the point of view of both employer and employee, it would be unwise to look too closely to immediate results and to neglect ultimate results. Unfortunately, however, the employer is usually in a position to take a long period view, whilst the employee is not.

The main thing the employer requires to provide for in taking a long period view is a continuous supply in sufficient numbers of those possessed of the kinds of abilities he requires for his purposes, and in so far as it may be necessary for him to train his staff so that they are especially suitable for these purposes, he is obliged to take a long view so as to make sure that he will have the necessary supply of workers in the future, as well as in the present. The employee, on the other hand, wants continuous employment of a kind suitable to his talents; but, together with that, he usually requires increasing rates of remuneration, because his wants have a very natural tendency to increase. This particularly applies to an employee who is comparatively young.

Essentials of a Wage System.—The first essential towards a solution of the wages problem is to devise a method of payment which will meet with the approval of workers and employers. The chief requirements are—

(1) The employer must have an adequate return for his expenditure, so that work must be done within a reasonable time, and must be of good quality.

(2) The minimum rate must have some relation to the cost of living in order to ensure a "living wage."

(3) The system of payment should be easily understood even by uneducated employees.

(4) Any rate, when once fixed, should not be altered without good cause.

(5) Wages must be adjusted equitably to meet changing conditions.

SYSTEMS OF PAYMENT.—Many different systems exist for the payment of wages, but those best known are Time, Piece, Task, and Progressive Wages. There are, of course, a great many modifications and combinations of these.

These systems will now be dealt with in the order shown in the following diagram—

METHODS OF REMUNERATION

- WAGES
  - Time
  - Task
  - Piece
  - Progressive
- WAGES + Share of Profit — Profit-sharing
- WAGES + Profit + Share in Management — Co-partnership
- WAGES + Profit + Full Management — Co-operative Production

TIME WAGES.—A time wage is the amount of conveniences and necessaries of life that a man obtains in exchange for a given *period* of his labour. In England the payment takes the form of a fixed sum of money per hour, day, week, month or year for the performance of a certain kind of work. The system of time wages is the one most in vogue in this country, owing to its many advantages. With regard to this system, the following may be stated—

(1) It is the most suitable, and is preferred by the employer and the employed where quality of work is of the highest importance and where quantity is of smaller consideration.

(2) Where the product is the result of a number of different operations, performed by different hands, it is difficult to assign a value to the share of work performed by any particular individual, and, therefore, time wages are usually adopted in such cases.

(3) Time wages are in favour where delicate machinery, which must not be subject to rough usage, is in use.

(4) Sometimes work has to be set by one worker for another; hence it would be unfair to pay the latter according to quantity of work done, since the amount he can do is regulated by another person.

TASK WAGES.—In the case of task wages, the labourer is paid according to the period of time he is engaged, but on condition that he does not turn out less than a certain amount of work during that period. If he is paid a certain weekly wage, he must complete a minimum amount of work. If he does more than this minimum he receives no extra remuneration. Naturally, task wages are disliked by workmen. They must be distinguished from piece wages.

PIECE WAGES.—These are payments of certain sums of money for the piece of work completed, or brought to a certain stage, without regard to the time occupied. The system of piece wages is not only preferred but is insisted upon in some districts where trade unions are very powerful. Other unions strongly object to the system and will not allow their members to accept it.

Of course, under a system of piece wages, quality need not be sacrificed to quantity, for that is purely a matter of adequate superintendence and inspection. As a rule, however, piece work does lead to more work being turned out in the time. This system of payment is in favour among a certain section of workers because it ensures that each unit of labour shall get its due reward.

Again, according to regulations, which are very easily made, piece work admits of consideration of the quality of the machinery placed at the disposal of the worker. In factories, the standardised wage takes into consideration the quality of the machinery.

In piece work a man is paid a certain rate per unit of work done, but when he is called upon to work with imperfect machinery, he cannot in the time produce the same quantity, so that the trade unions arrange that he shall be allowed more per unit of work.

Sometimes, however, the workers object to piece rates, particularly in the case of sub-contract work. Here the workmen are divided into groups, at the head of each being a foreman, who receives all the money and then pays out the piece wages to the men, keeping the rest for himself.

The chief disadvantages in connection with piece work are—

Moral. There is a temptation for the operative to rush his work during the first few days of the week, and then idle about.

Hygienic. Over-pressure may lead to a deterioration in the health and physique of the operatives, although the effects vary with different industries.

Economic. The adoption of piece rates may lead to the scamping of work. Very high speed is often detested by the best workmen because they take a pride in their work and prefer to finish it off properly. They dislike the prevailing motto of the piece work system, viz. " near enough."

An objection, which is quite fallacious, i.e. the lump of labour fallacy, is sometimes made to piece work. According to this theory, piece work leads to one man doing more, and, in consequence, leaving less to be done for other men, and thus causing unemployment. The shortest answer to this is that the argument proves too much. If unemployment is diminished by arranging for men to do less work, then it should be abolished altogether by arranging for them to do nothing.

As a matter of fact, this lump of labour fallacy is founded on a misconception of the construction of society. The idea underlying it is that there is a certain amount of work which must be done, and that this is divided out among a certain number of men. This is fallacious, however, for there is no definite quantity of work divided out among the men. Take any article, e.g. a box of steel pens. A certain number of boxes of steel pens will be sold in a year, but only on condition that they are sold at a certain price. Directly a measure is taken to raise their price, the demand for the steel pens will fall. The community will purchase a smaller number of boxes at the increased price. Hence the amount of work to be done is not stationary, but will be determined by the price of the commodity.

PROGRESSIVE WAGES.—In this case there is a fixed minimum time or piece wage supplemented with a premium for extra efficiency; that is, an increase of pay is given on an output above a certain amount, and a further increase on a still greater output. For instance, a wage of 160s. per week may be offered, together with ten shillings extra if the quantity produced exceeds a certain amount.

In a progressive system of wages, a man would get a certain piece rate up to a certain output, but beyond that output he would get a lower piece rate for additional quantities. The idea is to encourage briskness and at the same time to discourage rushing. If a worker can easily increase his output, it will pay him to do so, but the reward is not so great as to encourage him to increase his output beyond a certain point. However, if he is an exceptional workman, he is enabled to benefit by his extra efficiency.

Premium Bonus System. One of the best known forms of the progressive wage is the Premium Bonus System. Here the plan is for a standard time to be set for the performance of a certain amount of work, and then a premium is offered for every hour the workman can save in its execution. This is applicable in cases where large quantities of an article are turned out, the production of which involves the repetition of the same operations; for instance, the production of a nut for a certain part of a bicycle. Suppose a gross is normally turned out by a man in a week; then if he finishes his job before the stipulated time has expired, there is a saving, of which he will receive a share. This must be distinguished from actual profit-sharing.

PROFIT-SHARING.—This does not occur unless there is a definite contract made, between employers and employed, which is enforceable at law. In addition to the worker's salary, a fixed bonus in proportion to the net profits of the firm is usually given. In those occupations in which piece wages are difficult to arrange, time wages have often been found to necessitate a great deal of supervision. Hence, systems of profit-sharing have been devised to give employees an interest in the success of the undertaking.

Although individual schemes of profit-sharing may differ more or less in detail, they all contain this central idea—that in the long run it will pay the employer or those having a proprietary interest in a business to concede some share of the profits of the business to those who are engaged in it, over and above whatever they may be paid as wages for work done.

The arguments advanced in favour of profit-sharing are that as soon as one can get the employees financially interested in profits, they will also take a real interest in the business, so that they will become more careful in the use of materials and less wasteful in regard to time. It will, therefore, be possible to economise in the matter of superintendence, since the men will require less watching,

and to some extent will keep a watchful eye upon each other. In consequence the work turned out will be improved, and its value enhanced. Finally, these factors will tend greatly to reduce the risk of industrial disputes, strikes, or lock-outs, and the men being interested in the profits of successful management will be more ready to aid management with suggestions as to improved methods.

CO-PARTNERSHIP.—Profit-sharing is distinguished from labour co-partnership in that it does not involve sharing in the control of the undertaking. Co-partnership is an attempt to give to labour a share not only in the profit of industry, but in its responsibilities also, in the belief that successful enterprise depends on the hearty co-operation of all those engaged in it.

There is, it is true, great diversity between existing co-partnership concerns. At one extreme are such undertakings as the boot manufacturers at Kettering, whose system almost resembles productive co-operation, differing only in the fact that they have capitalists on the board of directors who do not work in the factory. In fact, the system may be described as productive co-operation leavened by capitalistic advice.

At the other end there are cases which are barely separated from profit-sharing. Here the operatives exercise but little control, the chief function of their representatives being to voice grievances.

Complete co-partnership involves—

(1) The payment of the existing standard wages of labour.

(2) The payment of a fixed rate of interest on capital.

(3) The division of the surplus profit between capital and labour in agreed proportions.

(4) The payment for part of the workman's labour by the allotment of shares in the capital.

(5) A sharing in the control of the business by the representatives appointed by labour.

Co-partnership is a recognition of the claims of the dignity of labour, while preserving the rights of capital.

PRODUCTIVE CO-OPERATION.—This has come about where small units of agriculture and manufacture owned by persons who possess little capital have combined for the purpose of sharing labour and buying or hiring machinery and processing equipment which individually they could not afford but the use of which when pooled by all members of the group will be economic. It is common in

dairy-farming, agriculture, wine-growing and similar occupations in Continental Europe, but in this country most examples of co-operative effort are to be found in distribution and not in production.

WORK STUDY.—In recent years the general tendency has been to seek ways and means of defining a fair day's work and fixing a fair wage for that work, and although all the above systems of remuneration can be found in use here, it is realised that the inducement to maximum production cannot come purely from the wage structure. Work study sets out first to study the method of working which is being used and any alternatives, in order to determine which is the best method to adopt. This being decided, time and motion study is introduced to assess a reasonable performance on the job and to agree with the union representatives a reasonable wage for that performance. After that the various incentives contained in the above methods of remuneration can be discussed and adopted if both sides are agreed on their suitability.

Such a study may call for complete re-layout of a factory or re-designing of the methods it has hitherto used, and it aims at reducing the superfluous effort and movement which is often found in the old methods. The introduction of work study has in many cases resulted in completely revolutionising methods formerly used, and has secured very considerable economies and increased productivity. It is essential, before it is introduced, to explain its nature to the people affected and to make it clear to them that it is not just a device to increase the amount of work they must do without adequate additional reward.

TEST PAPER

1. What effect have fluctuations in the purchasing power of money upon the relations between the employer and the employed?
2. Mention the chief systems in existence for the payment of wages.
3. Compare and contrast "Time," "Task," and "Piece" Wages.
4. Discuss the advantages and disadvantages of a system of paying wages to workmen at rates varying with the speed of the work. Give examples in connection with any industry with which you are acquainted.
5. State three different methods of remunerating workmen at rates varying according to the speed with which their work is executed, and discuss their relative advantages and disadvantages—
   (*a*) as compared with each other;
   (*b*) as compared with a fixed rate per hour.
6. What do you understand by profit-sharing and co-partnership? State the aims in each case and note any advantages that accrue from each and any difficulties that may stand in the way.

7. Enumerate the different methods of remuneration existing in modern British industry. Is there any connection between the " method " and the " amount " of remuneration?

8. State, with reasons and in order of merit, the types of wage payment by results most suitable for a factory turning out a uniform product of one size.

9. What do you understand by the term "work study"?

CHAPTER XVI

Goodwill of a Business

As a question of law, goodwill is recognised as the right to represent oneself as the successor to an established business. As a rule, it carries with it the right to use the trade name and also any trade marks that may have been employed in that business beforehand. The law regards goodwill as property which is transferable, and the rights acquired by a purchaser are accordingly enforceable provided that they are reasonable. The agreement to transfer usually contains a covenant that the vendor will not carry on a competing business within a given area or within a given time. Even if there is no such stipulation, the fact that a man has sold his goodwill to another is held to preclude him from canvassing former customers.

If a person or a company starts an entirely new business which has to be built up, its equipment put together and its organisation worked out, then, during the first few months, one cannot expect anything like such satisfactory profits as may be looked for later on, when the business is in proper working order, and it has acquired a certain reputation with the public. As a rule, a successful business has a satisfactory reputation with its customers. The result is that an established business, and particularly one with a good reputation, can naturally expect to make better profits than one which is absolutely in its infancy. This suggests that any concern which has overcome the initial stage of building up its reputation is in a better position than any new-comer which has to start from the beginning, even if the new-comer has advantages with regard to newer machinery, buildings, etc. The old business will hold its own until the new firm has established a reputation for good work.

Hence, it may be said that *goodwill is that intangible something which one associates with the reputation for conducting a business in a manner satisfactory to the customers*. It requires considerable energy, experience, and often the expenditure of much money in experimenting and advertising, before such a reputation is established.

If it is desired to sell the business after having rendered it into a profitable concern with a good reputation, payment may be expected

not only for the assets at the figures which appear in the accounts, provided they are reasonable, but also something over and above that amount for what is called the goodwill of the business; and the reason why people are prepared to pay for the goodwill of the business is because its acquisition places them in a position to earn larger profits than if they had to start a new business.

The price paid for the goodwill will depend chiefly upon the eagerness displayed by intending purchasers. A person very confident that he could establish a similar business in a few weeks would be less willing to pay a high price for the goodwill than another person with little energy and hope. In each case, if there is any real value in the goodwill it is because a purchaser may expect a distinct advantage from buying the business rather than attempting to build up a new one.

The question of goodwill centres round one or more of three things—

(1) **The Name.** Goodwill is closely connected with the name of the business; once that name has become well known to the public and associated in their minds with good value and service.

(2) **The Situation.** The actual situation of the business is, in many cases, more important than the matter of the name. A particular situation may be found to be very suitable for a particular class of trade, as in the case of a large hotel where proximity to a railway station is important.

In the case of a theatre, the situation is often more important than the name. If the theatre is removed from one place to another, although the name may be retained, it does not follow that the same number of persons will continue to patronise it. The same thing applies to shops. The goodwill of an ordinary retail shop is largely due to its situation, and so long as there is a draper's or a grocer's shop at the corner of a particular street, the people will continue to make their purchases at that place.

(3) **The Trade Mark.** Perhaps an even more stable form of goodwill than the name or address is the trade mark which is associated with the kind of goods desired by the people. Here the manufacturer gets into contact with the people because they know his goods. In this case, there is less risk that the goodwill will not be transferred, since it is the goods that are known and not the trader.

There will, of course, always be some part of goodwill which cannot be transferred, such as part of a medical practice which is due to the personality of the doctor. All that can be conveyed to the new-comer is the right to regard the patients as his customers. The patients may have such faith in the doctor that they may take his word as to the skill of his successor. But the goodwill of a medical man cannot be transferred like that of an ordinary commercial business.

If there be such a thing as a transferable goodwill, it must be possible to arrive at its price, and goodwill must come into the accounts as an asset. It will not be brought into the accounts while it is being built up, however, for its value is too uncertain to record.

If the business is being carried on with increasing profits, then it is reasonable to argue that the value of the goodwill is increasing, although it would be difficult to record the amount of the goodwill. It would be impossible to assess on a satisfactory basis the increase in value from year to year, and when it had been done the result would be useless.

Suppose the goodwill of a business had, in fact, increased by £1,000, it would not enable us to draw out a similar amount from the business, because there would be no addition to the amount of money. The practical effect of such a withdrawal would be that it would reduce the working capital by £1,000, thereby resulting in a lower efficiency, which would soon decrease the value of the goodwill. There is, therefore, no practical benefit derived from periodically assessing goodwill; in fact, this should be done only when the business is about to change hands.

With regard to partnership businesses, the need for valuing goodwill does arise when one of the partners dies and there is a sale of the business as a whole, or when there is a sale of part of the business, as when one partner retires and the continuing partners buy out his share. The place of the retiring partner may be taken by a new incoming partner, or there may be a new incoming partner without anyone retiring, in which case the additional partner acquires a share of the goodwill of the older partners. The goodwill being in reality the asset which represents the right to the future profits of the business, it will, in all cases, belong to the partners in the same ratio as they share profits unless there is a provision to the contrary.

The necessity arises, therefore, to find out the value of the goodwill of a business whenever the whole or part thereof is changing hands. Inasmuch as the goodwill is really the right to carry on the business and to receive its profits in the future, it is clear that the real value of the goodwill fluctuates as continuously as the profits themselves. When the necessity does arise to ascertain the value of the goodwill, it represents the price the vendor is willing to sell it for and the price at which the purchaser is willing to buy it. It would be necessary to show goodwill if we were making a statement of our wealth, but otherwise there is no need to value it.

On the death of a person, the property passes from the deceased to his executors or administrators, and duty has to be paid on his assets, including goodwill. Therefore, at death it becomes necessary to value goodwill to see what estate duties have to be paid. This is the only time when goodwill has to be valued except for the purposes of sale. On these occasions, the Commissioners of Inland Revenue are the final valuers of all property for the purposes of duty. There are no definite rules laid down, but the goodwill would be valued by them at decidedly less than its realisable value. In the matter of valuation, the Commissioners reserve a perfect freedom of action. But when it becomes a question of valuing the goodwill for the purpose of arriving at a deal between purchaser and vendor, then the matter is one of negotiation between the parties.

In many cases, however, the parties are willing to abide by the decision of a valuer, so that it is worth considering how it is valued at the time of sale.

METHOD OF VALUATION.—There is a common idea that the goodwill of a business is worth three years' purchase, that is, the actual amount of the profits earned during the past three years. Like many other popular ideas, there is not much foundation for this in practice. The goodwill is worth what it will fetch and nothing more. It would be manifestly unreasonable to apply the same principles to all kinds of business. To begin with, if the value is to be based on the profits of the last three years, it is quite possible for the same profits to be earned in two concerns, but in one there has been an increasing profit, whilst in the other there has been a falling off in the profits.

For instance, in one business, say A, the actual profits for the past three years may be £1,700, £1,600, and £1,500; whilst in B they are

£1,500, £1,600, and £1,700. No one would say that these two businesses were equally valuable because they have earned the same amount of profit during the past three years. The real estimate is on future profits, and the price should be based on what the vendor and the buyer think the future profits are likely to be; but since they do not know what the future profits will be, they have to assess on the basis of past profits. Hence, one only uses past profits because the future profits are not available for the purpose.

In the case of B it may be argued that the profits next year are more likely to be £1,800, whilst in the case of A they are more likely to be £1,400, so that on this basis the probability is that the goodwill of B is worth more than that of A.

It must also be remembered that in every kind of trade or occupation there are good years and bad years, quite irrespective of the fortunes of the particular business. There are years in which businesses will make good profits and years in which they will make small profits, and these periods of adversity and prosperity seem to come in cycles. There is a vast difference between the profits one may expect to earn in good times and those earned in bad times. Suppose in the case of B mentioned above, the highest point of the cycle had been reached, it is quite likely that the profit for the following year will reach only £1,600, whereas in the case of A the lowest point of the cycle might have been reached, and the profit next year would be greater.

In some concerns it will never pay to work at a loss, whereas in others a loss may be expected and withstood every few years. Hence, a much broader view of profits must be taken if a fair estimate of goodwill is to be obtained.

Moreover, other things being equal, the smaller the amount of capital that is invested to produce a profit, the more valuable will be the goodwill. Whatever capital has to be put into a business is ventured and is liable to loss. One business may work with £2,000, another with £10,000 capital, and both make the same profits. The usual plan is to charge interest at 5 per cent per annum on capital, and then consider the amount of profits as that remaining after the deduction of interest on capital, remembering that calculations of goodwill are based on profits. Further, the business which can be run profitably with the least management has the greatest amount of goodwill.

Analysis of Profits. The net profit which emerges from the trader's Profit and Loss Account is frequently capable of further analysis. It often happens, especially in a small business, that the trader has made no allowance for a management salary for himself, nor for a return by way of interest on his capital investment. If allowance were made for these matters at a suitable rate, the residue would consist of what the economist terms *pure profit.* This concept is designated by the accountant as *super-profit,* and the goodwill of a business may be expressed as so many years' purchase of this super-profit. This method is by no means free from difficulty since the allowance made for interest and salary must be very arbitrary in character.

Wherever reliable accounts are kept, there is no surer basis for the calculation of goodwill than by considering the net profits for a period of years. In doing so, it must be remembered that it does not necessarily follow because certain profits have been earned in the past that, in consequence, they will be earned in the future. The probability of their being earned in the future depends upon the conditions remaining the same, and on the transferability of the goodwill so as to allow the purchaser to carry on the business as satisfactorily as the vendor has done in the past.

In some cases a more rough and ready method has to be employed in the calculation of the value of goodwill, owing to the fact that no reliable accounts have been kept to show the past profits of the business. The practice has, therefore, grown up in many trades of assessing goodwill on the total sales for the year, as in the case of a draper's or grocer's shop. Sometimes the total sales in money and at other times the quantities handled are taken as the basis.

The goodwill having been purchased at a given price, it must now appear in the Balance Sheet of the firm as an asset. It is money invested with a view to assisting in the earning of future profits. Whatever, therefore, has been actually paid for the goodwill of a business may be regarded as capital expenditure, since it is money expended in acquiring a fixed asset.

TEST PAPER

1. What is the meaning of "goodwill"?
2. Trace the origin of "goodwill."
3. "The question of goodwill centres round one or more of three things." Criticise this statement, and name the three things referred to.

4. In what way does the location of a business influence " goodwill "?

5. Why is it necessary to estimate the value of " goodwill " on the retirement of a partner in a firm?

6. Enumerate the circumstances under which goodwill should be valued.

7. What factors should be taken into account in the valuation of goodwill?

8. Give an analysis of profits ; and bring out the main points of resemblance and difference between earnings of management and ordinary wages.

9. When should the value of goodwill be shown in the Balance Sheet?

10. Show the connection between goodwill and profits.

11. Assuming that you are a prospective buyer of a retail business, advertised as a " going concern," what inquiries would you make prior to actual negotiations, and how would you arrive at an estimate of the valuation?

12. In disposing of a retail business, what would you stress when taking goodwill into consideration?

CHAPTER XVII

ADVERTISING

GOODS and services having been produced must be distributed and sold. The function of advertising is to prepare the ground for sales by creating markets and demands, making goods known, and persuading the public that they should buy the goods. The techniques of publicity—i.e. informing and educating the public—are extensively used nowadays. Government departments and nationalised industries have Public Relations Officers whose function it is to inform the public of what their organisation is doing, explaining their actions and endeavouring to maintain good relations. Large firms by the use of house magazines, annual reports and similar handouts, and by arranging factory visits, endeavour to improve relations with their employees, shareholders, customers and the general public. Firms making producer goods which are not sold directly to the public at all (such as Imperial Chemical Industries) and those making luxury goods (e.g. Rolls Royce cars) the sale of which is not likely to be influenced greatly by advertising, employ the techniques as "prestige advertising" in order to keep their name before the public and destroy prejudices which might exist against them.

Members of many professional organisations (e.g. lawyers, stockbrokers, doctors) are not allowed to advertise their services. Their clientele is largely local and traditional or a result of direct introduction and would not be increased by extensive advertising which would only add considerably to the expenses of their businesses without adequate return.

Sometimes a Trade Association or Wholesale Association will advertise on behalf of a whole trade and not for a particular maker (e.g. "There is no substitute for wool"; "Beer is best"; "Say it with flowers"; "If you want to get ahead wear a hat").

But most advertising is undertaken by individual firms for their own product and is aimed at increasing their particular share of a market. This advertising may consist of regular repeat advertising to keep the name of the firm or product before the public, and this will be a regular part of the firm's selling expenses. Sometimes, however, a large-scale campaign is embarked upon, on which much more than the

usual annual advertising allocation is spent, with a view to widening the market or increasing the firm's own share of it as against its competitors, and such expenditure will usually be expected to show results over several years and be spread over that period for accounting purposes.

The cost of advertising must, of course, be counted in the general production and distribution expense which the ultimate sale price must cover, and it is therefore normally passed on to the public in the price of the article as sold. On the other hand, it is contended that if the result of advertising is to increase the market for goods and lead to greater sales, then the overheads of production and distribution are spread over a greater output and the unit cost of each article is decreased as a result of the economies made. In this way the advertising cost is absorbed, and the consumer will get his goods at a lower price than would be possible without that advertising.

Advertising may be effected through the firm's own advertising department or through an Advertising Agency which specialises in preparing and conducting campaigns for its individual clients.

There are many "media" through which advertising may take place—the Press (newspapers and magazines), outdoor posters and signs, posters outside or inside public transport conveyances, short films, radio or television programmes, direct mailed letters or handbills to members of the public in their homes, and point-of-sale advertising in shop window and counter displays.

Much market research goes into the preparation of an advertising campaign. First the qualities and attributes of the product to be sold must be studied; its good and bad points and best selling points must be determined. Then the existing competition, the particular section of the public likely to be interested in buying it, and the best ways of reaching that section must all be considered. The sum available for advertising and its best disposal over the most suitable forms of publicity must be worked out, and when the campaign has been decided upon, then the creative teams of copywriters and artists must get to work to build up an attractive and appealing advertisement or series of advertisements most likely to educate the public to the use of the product and to stimulate the desire to buy it.

The advertising experts know how best to reach sections of the public. Surveys are regularly made by research teams of people's

buying habits and motivations, their preferences and prejudices. These surveys are usually made by testing the reactions of a sample group of people. The sample must be carefully selected and must be completely representative of the group aimed at if the information and conclusions obtained from the survey are to be truly applicable to the wider section in prospect. There exist several surveys of newspaper and magazine readerships, for example, to indicate to the advertiser which periodicals or newspapers will be read by the sex, age-group, income-group or special interest-group at whom he wishes to direct his efforts.

Advertising has always been present in the selling of goods inasmuch as the sales "patter" of the salesman is advertising. But with the advent of mass-production it is necessary to organise mass-selling, and as the volume of output and extent of a market increases so does the volume and variety of advertising devices.

In an activity which adopts many psychological tricks and devices and often relies on emotional appeals, it is not surprising that criticism has often been raised on the ethics of advertising and the definitions of good and bad taste. There has been a big improvement in standards from the early days of this century when the pharmaceutical world, particularly, produced some bad examples in advertising cures for all ills, and the work of the professional bodies in advertising has established high standards which established members of the profession follow. Recent amendments to the law, such as the Merchandise Marks Act, 1955, have insisted upon greater accuracy in the description of products and their qualities.

TEST PAPER

1. Explain the real function of an advertisement.
2. Name the various methods of appeal which are used in advertising.
3. Mention any peculiar forms of advertising which have come into prominence within recent years.
4. What, in your opinion, would be the probable results of allowing the learned professions to advertise?
5. Analyse the economic effects of advertising. Discuss the advantages to (*a*) the manufacturer, (*b*) the retailer, and (*c*) the customer of the advertising of a given article.
6. You are about to open a retail establishment in your district. Describe the methods you would adopt to gain customers.
7. What is "prestige advertising"? Is it justified?
8. "Money spent on advertising is wasted money which merely adds to the cost of the article." Discuss this statement.

SECTION IV—TRADE

CHAPTER XVIII

Channels of Distribution

CHANNELS OF DISTRIBUTION IN THE HOME TRADE.—Under the present system of market distribution, merchandise ordinarily passes through the hands of one or more middlemen between the producer and the consumer. Prior to the Industrial Revolution, direct sale to the consumer was the normal method of disposing of the majority of commodities. As the scale of industry increased and it became more specialised, more highly localised and more complex, the need for one, and often for several, middlemen made itself felt, and the marketing system grew in complexity. The seller must devote considerable care to the selection of the proper method of distributing his product. Conditions change, and new types of middlemen come into existence or increase in importance, while old types lose ground in the competitive struggle. Again, the demand for a product changes. Thus, a new product may be marketed by the direct mail method, but when it becomes known the retail stores may offer a larger outlet. A wide variety of methods are in use, not all of which are open to every seller, but the following are amongst the most important—

(1) **Direct Sale to the Consumer.** Although the growth of specialisation has created numerous trading intermediaries, the stress of competition has in certain cases caused producers to undertake all the services which it was once the merchant's special task to perform. In some cases direct sale to the consumers is a comparatively simple matter as, for instance, in the industries producing capital goods. Manufacturers of locomotives or electrical generating plant can sell direct to the consumer, since demand is not dispersed among the general population, but is concentrated at comparatively few points. Direct sale may also occur between grower and consumer in the marketing of agricultural produce. This method appears to be generally successful where the small producer hawks his produce in the nearest town, or, to a less extent, through the medium

of a retail shop or a stall in the local market. Direct sale is mostly undertaken by growers situated within driving distance of a town of sufficient size to provide an adequate and regular outlet for the whole of the produce. The varieties raised must be sufficiently diverse to enable the grower to supply the greater part of the needs of his customers, but difficulties inevitably arise, such as non-continuity of supply and the unforeseen requirements of customers, which compel the grower at times to purchase produce for resale in order to maintain his connection.

(2) **Direct Sale to Retailer.** The next shortest trade channel is followed when the goods pass through the hands of one middleman, i.e. the retailer, between the producer and consumer. The sale of farm produce for local consumption provides the most familiar and the longest established example of direct sale by the producer to the retailer. It is a well-established custom for the larger growers of mixed crops within easy driving distance of large towns to organise the sale of their own produce and dispose of it to retailers at the wholesale markets. A much more recent development, however, is the growth of direct sale to the retailer by manufacturers who are producing for the general market. This tendency to eliminate the wholesaler manifests itself in a variety of forms. It may be due to the initiative of the manufacturer who sends his own travellers to the retail shops. On the other hand, it may be due to the large retailer who sends his buyers to the manufacturer, or who, by establishing a chain of stores managed from a central office and served by a central buying department and warehouse, virtually sets up his own wholesaling organisation. When the initiative comes from the side of the manufacturer, certain conditions must be fulfilled before a policy of direct sales to retailers can succeed—

(*a*) The manufacturer must produce on a large scale in order to make it worth his while to organise such a method of distribution. He must also possess the necessary capital to finance the marketing operations.

(*b*) The demand for the article must be constant throughout the year. It is not worth maintaining one's own sales force if it cannot be employed the whole year round because of sharp seasonal fluctuations of demand.

(*c*) Direct sale will be impossible if the manufacturer is a specialist whose products are only bought in limited quantities by each

individual retailer. This does not apply to expensive specialities which are only stocked by a limited number of high-class dealers.

(*d*) The manufacturer with a "full" line of goods is most likely to be successful with such a policy. The expense of a salesman handling many articles can be spread amongst them, thereby reducing the burden on each.

(3) Sale to Wholesalers. Wholesalers have for many years been established as middlemen through which many goods pass between the manufacturers and the retailers. The wholesaler most commonly retains his position of importance in the sale of bulk goods which are manufactured on a small or moderate scale and which are neither proprietary nor branded articles, and in whose disposal advertising to the consumer consequently plays little or no part. Among the more obvious examples of such goods are the commoner kinds of glass and china, hardware, and textile fabrics. The wholesaler has a sales force calling upon retailers regularly, and usually has lower selling expenses than the manufacturer who sells direct to retailers, since his sales force represents many manufacturers. He also performs many of the other marketing functions, such as assembling, storage, and finance. From the point of view of the manufacturer, however, an over-dependence upon the wholesaler causes him to lose contact with retail dealers. Again, many wholesalers have so many products to sell that they are unable to push the sales of all goods carried in stock. The wholesaler, too, may at any time discontinue one manufacturer's line to take over a competitive line, or to put out his own branded goods. In using this channel, therefore, the manufacturer must consider whether he can perform the wholesale functions or services, and whether he can perform them better or cheaper than the wholesaler. If his product requires aggressive salesmanship, he may find it desirable to go direct or to make arrangements with selected wholesalers under which they will put real sales effort behind his product.

(4) Exclusive Agencies. Manufacturers often sell through a limited number of dealers who are granted exclusive agencies in their respective territories. The agency contract may require the dealer to buy certain minimum quantities of merchandise, whilst the contract may be made to cover a definite period, or it may be for an indefinite period, either party having the right to cancel it at any time upon due notice. The main argument in favour of

exclusive agencies is that they get more interest and more sales effort from the dealers, so that the volume of sales is increased. The dealer with an exclusive territory has more interest in the product; he advertises it more, as he feels that no other dealer will profit at his expense. Exclusive agencies are desirable when service is important, or when the manufacturer wishes to control the merchandising policy of the dealers.

(5) **Sales Through a Manufacturers' Agent.** The producer who does not wish to give up direct contact with his customers, and who wants to be represented permanently in a certain area, but who wishes to avoid the expense of a branch, will engage a suitable agent. Such an agent has the advantage that he is familiar with the business conditions of his district, and that he knows a number of prospective customers. Especially in large cities, where demand is great and the occasional visitation of customers by travellers is not sufficient, permanent representation by an agent is to be preferred. The manufacturers' agent does not act in his own name, but in the name of his principal, on whose behalf he enters into dealings with customers. He has a contractual relationship only with his principal. This relationship is generally entered into for an indefinite period, so that during its existence the agent is permanently engaged in safeguarding the interests of his principal.

(6) **Sales Through Commission Agents.** The existence of these agencies is frequently due to a specialisation of function in the wholesale trade. Such agents are frequently employed in the marketing of agricultural produce. This agent concludes all business in his own name, so that the relation between the principal and the commission agent does not concern the third party at all. This mode of trading is illustrated by the work of the commission salesman in the fruit and vegetable trade. This salesman, who frequently sells to a wholesaler, endeavours to strike the best possible bargain on behalf of his clients. In addition to the actual service of finding customers, the salesman usually supplies the grower with the bags, baskets, or other containers in which the produce is packed and pays on the grower's behalf any freight or other charges which may be due. In some cases he advises the grower as to the state of the market, warning him when the forwarding of produce is inadvisable; he also accepts responsibility for any bad debts which he may incur in the process of sale. For his services he charges a commission on

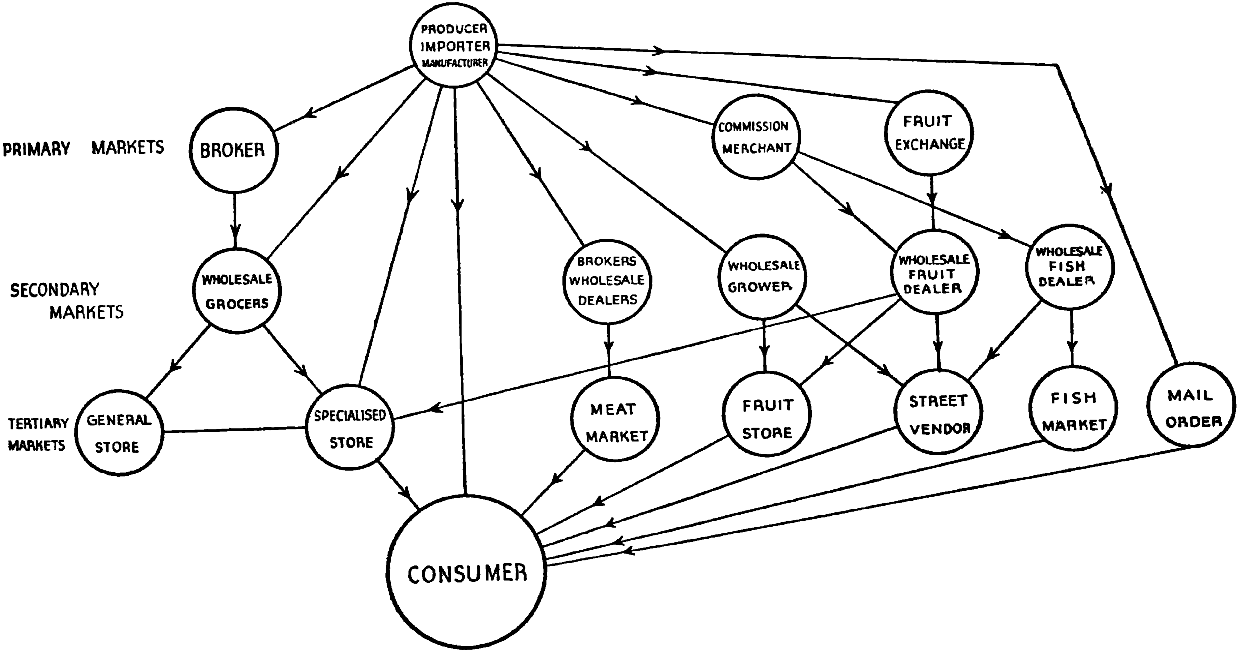
the selling price, or occasionally a flat rate on a quantitative basis, this remuneration being deducted from the price realised, together with other incidental charges such as rail transport, cartage, porterage, market dues, and a charge for the use of empties.

The various channels through which supplies of foodstuffs reach the ultimate consumer in the home trade are shown in the illustration on the opposite page. It will be seen that the primary markets consist of intermediaries proper whose function is to direct the foodstuffs from the home grower or importer into wholesale channels. These are indicated on the diagram as Secondary Markets, since they receive their supplies at second hand and for the most part are not in direct contact with the producer or importer. They are, however, conveniently situated to serve the needs of the various types of retail trade which are described collectively as Tertiary Markets. Elimination is possible at every stage, the most direct route being that between producer and consumer, in which case there are no intervening links.

CHANNELS OF DISTRIBUTION IN THE EXPORT TRADE.—There are many complications in the export trade which do not occur in the case of trade in the home market. Supplies must be adapted to the special needs of peoples with whom the exporter is not in touch; there are customs, traditions and prejudices peculiar to every race, which in many cases affect the sale of goods. Questions of freight and packing have outstanding importance; customs charges vary considerably in the different countries; and finally, the modes of payment, which again are subject to many variations, must be carefully ascertained. All these things have no parallel in the home market and demand careful consideration. The export trade, as a branch of intermediary trade, may be conducted either on one's own account or on a commission basis. From the point of view of the manufacturer, the export trade may be undertaken by the direct or the indirect method. Where direct exporting is decided upon, the manufacturer exploits his own markets, chooses his own methods of developing business and shoulders the entire responsibility for all operations. Under the indirect method, the work is handed over to some specialised intermediary. The following are the principal channels of export—

(1) **Manufacturer's Export Department.** Direct exporting, that is to say, the exportation of goods by the manufacturer to the importer

CHANNELS OF FOOD DISTRIBUTION IN THE HOME TRADE



on the one side, is as a rule only economical when the manufacturer is in a sufficiently large way of business to enable him to establish an export branch in connection with his own sales department. The export business presents so many peculiar problems that it is best for a manufacturer to handle the whole of his export business through a separate department. He may then proceed to open up relations with his market through the medium of travelling salesmen. The success or failure of the manufacturer working on these lines will depend just as much upon the qualifications of the persons he sends overseas, as the quality, utility, or price of his wares. The personal element is just as important a factor in the foreign as in the home trade. A second means of opening up foreign markets is through the medium of correspondence. This is an economical way of commencing business, but it demands the highest qualifications of the man who is conducting the campaign.

(2) Foreign Branches. In the case of large businesses, manufacturers have established foreign branches as a means of opening up a direct connection with an overseas market. This method has the supreme advantage of enabling the concern to maintain a close contact with conditions in the market. Credit problems are reduced to a minimum, since the man in charge can investigate, on the spot, the customer's capabilities for meeting his obligations. In Canada, for example, some firms have established branches in charge of a manager, with control of salesmen and stocks at one or more points. This policy has been adopted in trades such as tool steel, food products, and chemicals. In other cases the Canadian branch has had the benefit of repair shops, as in the case of the trade in machine tools and electric motors. Under such a policy it is necessary to have an adequate selling organisation, stocks at important points, and total overhead expenses in a proper relation to the business available.

(3) Joint Selling Associations. The formation and maintenance of an export department, or the operation of foreign branches, requires a considerable expenditure of capital, which is justified only when the amount of business done with overseas customers is exceptionally large. If, however, the cost of maintaining a branch and of carrying stocks is more than a given article will bear by itself, the obvious solution is for a number of firms manufacturing allied articles to share such overhead expenses in their common interest—in other

words, to form a joint sales organisation. Thus, in the Brazilian trade, Continental and United States manufacturers have opened showrooms for their agents and have deposited goods on consignment in charge of capable men sent out to demonstrate them. This has been made possible by the combination of manufacturers whose products, not competing with each other but related in character, are capable of demonstration together in the same showroom. Each firm contributes to the upkeep of the showroom and the orders which are taken are handed to the respective manufacturers of the goods. Experts attached to these depots, which are especially suitable for machinery or engineering products, are prepared to furnish plans and information as to the working of new machinery. British firms have shown themselves slow to adopt this form of organisation, though such an association exists in the machine tool trade.

(4) The Merchant Shipper. This type of export organisation has a longer tradition than any other, for it is the pioneering form which Great Britain adopted to lay the foundations of her overseas trade. Export merchants of this class, trading on their own account still play an important role in international trade. It is especially when dealing with backward countries, in which commercial and banking facilities are not well developed, and where the financing of business presents many difficulties, that the export merchant is a most useful intermediary. His position has been materially weakened in those places where there are large importing firms possessing sufficient capital and credit to enable them to deal directly with foreign manufacturers. The merchant system has the danger to the manufacturer that it prevents him from becoming fully acquainted with the requirements of his market. Yet, in spite of this, the merchant shipper performs valuable functions, as in the case of the cotton trade, where—

(*a*) He finances the goods from the time they leave the manufacturer, through the finishing processes, until after they have been sold in the country to which they have been exported.

(*b*) He has to know from what manufacturer he can obtain particular kinds or qualities of goods and where to secure the particular finish that is required.

(*c*) He must have intimate knowledge of the requirements of the markets in which he trades, and of all the conditions. He

must also pay careful attention to packing and shipping arrangements.

(5) **Export Commission Houses.** These are primarily representatives of foreign importers on whose behalf they act in the exporting country. Their main function is the purchase of goods in accordance with instructions received from foreign concerns, the latter paying them a commission for their services. These firms are familiar with the best sources of supply from which they may obtain the goods needed by their clients abroad, their information being kept up to date by special investigations as well as from trade periodicals, etc. Buying instructions which they receive from abroad may be either to purchase from a named concern, or to place the order wherever they may obtain the most advantageous terms. Owing to the increase in the number of widely advertised trade-marked and branded goods, the trend is towards making instructions from abroad specific, thus leaving little room for the exercise of discretion on the part of commission houses.

(6) **Manufacturers' Export Agents.** There are various types of manufacturer's export agencies. Some agents have no extensive organisations; they are individuals residing in a seaport and having for their function the distribution of catalogues, circulars and price lists among firms engaged in exporting; other agents are established in foreign countries where they act as resident salesmen for a group of manufacturers; still others are large concerns having extensive selling, shipping, and financing departments, and maintaining an office at one or more of the large ports. A great deal of the British export trade is done through agents in overseas markets. It is stated, however, that a certain amount of trade is lost to this country each year through insufficient care on the part of British manufacturers in the selection of their agents abroad, and through defective supervision of the agents when appointed. The disadvantage of placing one's export sales in the hands of an export selling agent is due mainly to the fact that he represents an independent organisation; he is not an employee of the manufacturer whose sole interest is the development of the latter's business. An agent often works on a time contract, and seeks immediate results irrespective of whether the sales make or do not make a solid foundation for the growth of the manufacturer's export trade. Such an attitude of exporter's agents is to some degree justified by the loss of accounts

which many of them sustain after they have done some valuable initiatory work, the manufacturer then deciding that he wants to assume direct control of his foreign trade.

TEST PAPER

1. Enumerate briefly four different channels of distribution which may be adopted by the producer in the disposal of his goods to the home consumer.

2. State concisely the conditions under which it is advantageous for the producer to sell directly to the consumer.

3. What are the conditions which must be fulfilled before a policy of direct sales by the manufacturer to the retailer can succeed?

4. If all wholesale business were abolished and goods were sent directly to the retailer from the producer, in what ways would the shopping public probably be affected?

5. What is the advantage to a manufacturer of granting exclusive agencies to a limited number of dealers?

6. What functions are performed by (*a*) manufacturers' agents and (*b*) commission agents, in the distribution of goods between the producer and the consumer?

7. "A business man, in these days, is a specialist, whose services in the placing of goods are as important as those of the technical expert in their production." Comment upon this statement.

8. Classify the types of middlemen who may intervene in the passage of goods from home producer to home consumer, and point out the reasons for the existence of each of the types you mention.

9. Enumerate three important channels of distribution employed by the home manufacturer in the export of his goods abroad.

10. Under what circumstances is it advisable for a manufacturer to establish an export branch in connection with his own sales department?

11. What justification is there for the establishment by a manufacturer of a branch in a foreign country?

12. Show the necessity for the following in the export of merchandise, and put a reasonable limit to their operations—

(*a*) The merchant shipper.
(*b*) The export commission house.
(*c*) The manufacturers' export agent.

13. Discuss the extent to which association of producers are in a position to eliminate the independent middleman.

14. "One of the root causes of the world situation at the present time is the fact that we have solved during the last hundred years the problem of production, but we have not solved the problem of distribution." Comment on, and consider the adequacy of, this diagnosis.

CHAPTER XIX

THE PURCHASE AND SALE OF GOODS

THE success of a trader's business depends to a large extent upon the manner in which the purchase of the stock is effected: the more expert the buying, the easier and more beneficial will prove the sale. The old adage is "Goods well bought are already half sold." Where the tastes and requirements of the customers are wrongly anticipated, the goods may prove altogether unsaleable. Sudden changes in fashion, new inventions, and unemployment may also prevent the sale of goods.

Since all buying is effected with a view to subsequent sale, it follows that both buying and selling are activities which should be carried on in the closest co-operation. In some undertakings the person in charge of the buying is also responsible for the selling, but whether this is the case or not, the buyer should possess an intimate knowledge of the merchandise in which he deals, as well as of the legal principles involved in buying and selling.

GENERAL CONDITIONS OF PURCHASE.—The main factors which the trader has to consider when making his purchases are the quantity, quality, price, payment, packing, and the time of delivery of the goods.

Quantity. The quantity of goods purchased by the retailer will naturally vary with the conditions of the market. It is the duty of the seller to deliver the exact amount which has been ordered. In the event of the delivery of a wrong quantity, the rules, subject to any usage of trade or special arrangement of dealing between the parties, are—

(1) Where the seller delivers to the buyer a quantity of goods less than he contracted to sell, the buyer may reject them. But if the buyer accepts the goods so delivered he must pay for them at the contract rate.

(2) Where the seller delivers to the buyer a quantity of goods larger than he contracted to sell, the buyer may either—

(*a*) Accept the goods ordered and reject the rest, or

(*b*) He may reject the whole.

If he accepts the whole of the goods so delivered he must pay for them at the contract price.

(3) Where the seller delivers to the buyer the goods he contracted to sell mixed with goods of a different description not included in the order, the buyer may—

(*a*) Accept the goods which are in accordance with the contract and reject the rest ; or

(*b*) He may reject the whole of the goods.

Quality. There is an infinite variety of materials all differing in quality. After they have been collected from the extractive and manufacturing industries, they are next assorted and classified into different qualities, and may then be regarded as merchandise in the truest sense of the word. The goods are mixed, cut, refined, etc., and then grouped into recognised types each having its different characteristics. One of the most important points in a contract of sale is the determination of the exact quality which the buyer has in mind.

With regard to the quality of the goods, including their state or condition or their fitness for any particular purpose, there is no implied warranty or condition except as follows—

(*a*) An implied warranty or condition may be annexed by the usage of trade or by the provisions of a particular statute, e.g. The Merchandise Acts, 1887.

(*b*) Where the buyer makes known to the seller the particular purpose for which the goods are required so as to show that the buyer relies on the seller's skill or judgment and the goods are of the description which it is in the course of business to supply, there is an implied condition that the goods shall be reasonably fit for such purpose.

The *quality* is usually indicated by the buyer in one of the following ways—

(1) General description of the goods.
(2) Sample or pattern.
(3) Analysis.
(4) Type or grade.
(5) Trade mark or brand.

DESCRIPTION. In the case of a contract for the sale of goods by description there is an implied understanding that the goods shall correspond to the description. Particular qualities of goods have

particular descriptions, such as Yorkshire Hams, Paisley Flour, English Cheddar, Japanese Silk ; and when such goods are ordered the contract is fulfilled only when the commodities answer to their description. Sometimes goods are sold by sample or pattern as well as description, e.g. 200 yd. Japanese Silk No. 879, where the number indicates the particular pattern of the silk.

SAMPLE OR PATTERN. A sample is a small quantity of an article produced by the buyer as a specimen of the goods desired. A great variety of merchandise such as sugar, spirits, wine, coffee, etc., is sold by sample. A pattern is a specimen of a manufactured article such as cloth, paper, silk, leather, etc. When goods are sold by pattern or sample, the seller guarantees that the goods shall at least equal, on an average, such sample or pattern. In the case of a contract for sale by sample or pattern three conditions are implied—

(*a*) That the bulk shall correspond with the sample or pattern in quality ;

(*b*) That the buyer shall have a reasonable opportunity of comparing the bulk with the sample or pattern ; and

(*c*) That the goods shall be free from any defect rendering them unmerchantable which would not be apparent on a reasonable examination of the sample.

ANALYSIS. Many products are sold upon analysis, that is to say, on the basis of a determined quality, so that the exact composition of the goods supplied is then arrived at by the analyst. If the quality of the goods delivered is inferior to that stipulated in the contract, a proportional allowance is made ; if it is superior, then there is a proportional increase in the price. As a rule, the contract gives the name of a chemist who is to be entrusted with the analysis, whilst in the case of many products there are special laboratories whose certificates of analysis are accepted without question.

TYPE OR GRADE. When goods are sold "to arrive"—as in the case of corn, coffee, rice, etc.—their quality is determined according to type or grade. This is a standard sample taken from the crop in the early part of the season, and the year's growth is guaranteed to be equal to the grade. Should the produce prove to be inferior, an allowance is usually made, the amount being settled by arrangement or by arbitration.

TRADE MARK OR BRAND. Goods, and especially manufactured goods of small value, tend more and more to be sold according to *trade mark* or brand. The mark signifies the quality of the articles and facilitates the task of the purchaser; he knows that on demanding an article of a certain mark, he will receive a definite quality which will meet his needs. Hence, there is no need to spend time in selecting the goods.

Price. In a contract of sale, the price may be fixed by the terms of the contract, or may be determined by the course of dealing between the parties; and in other cases a reasonable price must be paid. The successful seller gives as little trouble as possible to the buyer in the quotation of his prices. Hence, the custom has developed of quoting prices inclusive of carriage, Customs duties, packing, etc., which are incidental to the purchase.

Payment. The payment of the price of the goods might be made immediately or after the expiration of a fixed period of time. C.O.D. (i.e. Cash on Delivery) terms are such as compel the buyer to pay for goods immediately before they are handed over to him. " Prompt Cash " means payment practically as soon as the goods are delivered. In actual practice, it allows time to examine the goods; and whilst in no case should it exceed seven days, the average time is three days. " Net " or " Ready Cash," sometimes termed " Cash," means settlement within a period of ten days. In case there is a discount, this is deducted from the invoice or statement before the account is paid. In many trades the cash discount is 2½ per cent and it is usually allowed if payment is made within one month.

Cash Discount is a deduction from the invoice price, which is granted to the buyer when payment is made in cash or before the expiration of a customary period of time. This form of discount is to be distinguished from *Trade Discount,* which is given either as a custom of the trade or on some special consideration, such as the taking of large quantities or regular orders. In many wholesale trades, it is usual for the catalogue price of the goods to remain stationary; but when the market rises or falls, the trade discount is reduced or increased. In reality, trade discount represents the retailer's profit, and is deducted from the invoice prior to entry into his books of account.

Packing. In the case of many manufactured articles of general

consumption, packing plays a most important part. Its object is not only to protect the goods from damage, but also to induce their sale. When goods are sold in packages or cases, there are three distinct weights to be taken into consideration—

(1) The actual weight of the goods, which is known as the *Net Weight.*

(2) The combined weight of both goods and package—known as the *Gross Weight.*

(3) The weight of the package in which the goods are enclosed —known as the *Tare.*

In most trades there is a recognised allowance made for the tare ot the case, cask, chest, or other package in which the goods are secured.

Actual Tare means that the package has been weighed separately from the goods before they were packed; *Average Tare* is taken where the packages are numerous, and of a similar size or shape, and only a few have been weighed to form an average for the whole; while *Customary Tare* is an established allowance made in some trades for the weight of packages which are so invariably alike, and of such uniform weight, as to warrant a fixed percentage allowance being made for them.

Time of Delivery. Delivery may be made at once or within a certain period of time. Wholesale and retail traders engaged in the home trade endeavour to stock goods in order to meet the demands of their customers as they arise. This is not usually the case, however, with regard to the manufacturing trade nor with the import and export trade. The manufacturer usually keeps a reserve of raw materials and arranges for further quantities to be delivered at regular intervals. In the export trade, the time of delivery is based on the date of the ship's departure. In the import trade, *spot transactions* are those in which the goods can be delivered immediately. When the goods are sold *To Arrive*, it means that they are in course of transit from abroad, and will be delivered on the arrival of the vessel by which they are being conveyed.

LEGAL MEANING OF "GOODS."—For the purposes of the Sale of Goods Act, 1893, the term "goods" means all chattels personal other than money and things or choses in action, such as shares, debentures, bills of exchange, and promissory notes. The term also includes—

(*a*) Emblements, i.e. those vegetable products of the soil which are produced annually, not spontaneously, but by the labour and industry of the cultivator; such as corn and grain of all kinds, hemp, flax, hops, and potatoes.

(*b*) Things attached to land or forming part of the land, which are agreed to be severed either before sale or under a contract of sale, e.g. the timber in trees which are still standing at the time of the transaction, whether it is sold at so much per foot, or at a fixed price, and whether it is to be cut by the seller or the buyer.

It will be seen that the legal meaning is much narrower than that of "economic goods," which is given on page 6.

KINDS OF GOODS.—The goods which form the subject of a contract of sale may be either—

(1) Existing goods, i.e. goods which are owned or possessed at the time of the contract of sale, or

(2) Future goods, i.e. to be manufactured or acquired by the seller at some future time after the making of the contract.

The goods, again, may be either—

(*a*) Specific or ascertained goods, i.e. goods identified and agreed upon at the time when the contract of sale is made, or

(*b*) General or unascertained goods, i.e. goods not so identified but described or referred to by the parties in general terms.

Where there is a contract for the sale of specific goods and the goods without the knowledge of the seller have perished at the time when the contract is made, the contract is void, e.g. if A contracts to sell to X a cargo of corn on board a ship which is supposed to be then on its voyage but which is in fact lost, the contract is void.

Where there is an agreement to sell specific goods and subsequently the goods without any fault on the part of either the seller or the buyer perish before the risk passes to the buyer, the agreement is thereby avoided; e.g. if A agrees to sell X 10 tons of potatoes to be grown on a particular farm and the crop fails, the agreement is avoided.

FORM OF CONTRACT OF SALE.—A contract of sale may be—

(1) In writing; or
(2) By word of mouth; or
(3) Partly in writing and partly by word of mouth; or
(4) Implied from the conduct of the parties.

The Sale of Goods Act, 1893, collected into one code all the rules relating to the purchase and sale of goods. All the rules of the law of contract apply to it, so that there must be competent parties, good consideration, mutual consent, and all the other elements necessary for the validity of any other kind of contract.

NATURE OF A CONTRACT OF SALE.—A contract of sale of goods is a contract whereby the seller either—

(*a*) transfers, or
(*b*) agrees to transfer

the property in goods for a money consideration called the price. Hence the term " Contract of Sale " includes—

(1) Cases where the property in the goods is at once transferred from the seller to the buyer under and by virtue of the contract of sale, in which case the transaction is called an " executed " contract of sale, or a " sale " simply.

(2) Cases where the transfer of the property in the goods is to take place at a future time only, or subject to some condition afterwards to be fulfilled, in which case the transaction is called an " executory " contract of sale or an " agreement to sell."

But an agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred. Similarly a seller means a person who: (*a*) sells, or (*b*) agrees to sell; and a buyer means a person who: (*a*) buys, or (*b*) agrees to buy goods. The distinction between a sale and an agreement to sell is important in at least three respects—

(1) Where goods have been sold and the buyer makes default, the seller may sue him for the contract price. But where an agreement to buy is broken, the seller's remedy is an action for damages. He cannot sue for the contract price because the property in the goods has not passed.

(2) If an agreement to sell is broken by the seller, the buyer has only a personal remedy against the seller because the goods are still the property of the seller, so that he can dispose of them as he likes; and if he becomes bankrupt, they pass to his trustee in bankruptcy, who may, if he so choose, disclaim the contract. But if there has been a sale, the buyer has the usual proprietary remedies in respect of the goods themselves, and in many cases can follow them into the hands of third parties.

(3) If there is an agreement for sale and the goods are destroyed, the loss falls on the seller; but if there has been a sale, the loss usually falls on the buyer, even though the goods may never have come into his possession.

In order that a transaction may amount to a contract of sale, the consideration for the contract must be money, either paid or promised, which is called the *price*.

Where the consideration for the transfer of the property in goods from one person to another consists of other goods, the contract is not a contract of sale but a contract of *exchange* or *barter*. Where goods are transferred from one person to another without any price or other consideration being given in return, the transaction is called a *gift*.

RIGHTS OF THE BUYER.—The buyer is entitled to delivery of the goods in accordance with the terms of the contract of sale. The **rules as to delivery** are—

(1) Whether it is for the buyer to take possession of the goods or for the seller to send them to the buyer is a question depending in each case on the terms of the contract. Apart from any contract, the place for delivery is the *seller's place of business*, if he has one, and, if not, his residence. But if the contract is for the sale of specific goods which, to the knowledge of the parties when the contract is made, are in some other place, that place is the place of delivery.

(2) Where, under the terms of the contract, the seller is bound to send the goods to the buyer, but no time is fixed, the seller must send them within a reasonable time.

(3) Where the goods at the time of sale are in the possession of a third person, there is no delivery by the seller to the buyer unless and until such third person acknowledges to the buyer that he holds the goods on his behalf.

(4) Demand or tender of delivery may be treated as ineffectual unless made at a reasonable hour, what is a reasonable hour being a question of fact. For example, 6 p.m. would be considered an unreasonable hour at which to tender goods to a warehouse.

(5) Unless otherwise agreed, the expenses of putting the goods into a deliverable state must be borne by the seller. If the goods sold are delivered not to the buyer directly, but to some carrier, the rules are—

(*a*) Where the seller is authorised to send the goods to the buyer, delivery of the goods to a carrier, whether named by the buyer or not, for the purpose of transmission to the buyer is deemed to be a delivery of the goods to the buyer.

(*b*) Unless otherwise authorised by the buyer, the seller must make such contract with the carrier on behalf of the buyer as

may be reasonable, having regard to the nature of the goods and the other circumstances of the case. If he omits to do so, and the goods are lost or damaged in course of transit, the buyer may either—

(i) Decline to treat the delivery to the carrier as a delivery to himself; or

(ii) May hold the seller responsible in damages.

Unless otherwise agreed, where goods are sent by the seller to the buyer by a route involving **sea transit** under circumstances in which it is usual to insure, the seller must give such notice to the buyer as may enable him to insure the goods during their sea transit, and if the seller fails to do so, the goods are deemed to be at the seller's risk during the sea transit.

Where the seller of goods agrees to deliver them at his own risk at a place other than that of the place where they are when sold, the buyer must, unless otherwise agreed, take any risk of deterioration of the goods necessarily incident to the goods during the course of transit.

CONDITIONS AND WARRANTIES.—The buyer is entitled to have any conditions and warranties relating to the goods duly observed and performed.

A Warranty means any stipulation with reference to the goods which are the subject of a contract of sale, but collateral to the main purpose of such contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated.

A Condition is a similar stipulation which is an essential term of a contract, so that it goes to the root of the contract and the breach of which may, therefore, give rise to a right to treat the contract as repudiated. Whether any particular stipulation in a contract of sale is a condition or warranty depends in each case upon the construction of the contract, but—

(1) It may be a condition although called a warranty in the contract.

(2) Unless a different intention appears, stipulations as to time of payment are not deemed to be of the essence of a contract of sale, but whether any other stipulation as to time is of the essence of the contract or not depends upon the terms of the contract.

The general rule of English law is expressed in the maxim *caveat*

emptor (i.e. let the buyer beware); hence, in the absence of any expressed stipulation by the buyer, the law will not imply any conditions or warranties in favour of the buyer except those mentioned below.

In every contract of sale, unless the terms of the contract are such as to show a different intention, there is—

(*a*) An implied condition on the part of the seller that, in the case of a sale, he has a right to sell the goods, and that, in the case of an agreement to sell, he will have the right to sell the goods at the time when the property is to pass.

(*b*) An implied warranty that the buyer shall have and enjoy quiet possession of the goods.

(*c*) An implied warranty that the goods shall be free from any charge or encumbrance of a third party not declared or known to the buyer at the time when the contract is made.

RIGHTS OF THE SELLER.—Rights against the Buyer. The seller has the right to require the buyer—

(1) To accept the goods; and
(2) To pay for the goods,

in accordance with the terms of the contract of sale.

The buyer is deemed to have accepted the goods—

(1) When he intimates to the seller that he has accepted them;

(2) When the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller (e.g. if he re-sells them); or

(3) When, after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them.

Unless otherwise agreed, when goods are delivered to the buyer and he refuses to accept them, having the right to do so, he is not bound to return them to the seller, but it is sufficient if he intimates to the seller that he refuses to accept them. When the seller is willing and ready to deliver the goods and requests the buyer to take delivery, and the buyer does not, within a reasonable time after such request, take delivery, he is liable to the seller—

(1) For any loss occasioned by his neglect or refusal to take delivery; and

(2) For a reasonable charge for the care and custody of the goods

In all cases unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions; that is to say, the seller must be ready and willing to give possession of the goods to the buyer in exchange for the price, and the buyer must be ready and willing to pay the price in exchange for the goods.

Rights against the Goods. Notwithstanding that the property in the goods may have passed to the buyer, an unpaid seller has by implication of law—

(*a*) A lien on the goods for the price while he is in possession of them;

(*b*) In case of the insolvency of the buyer, a right of stopping the goods in transit after he has parted with the possession of them; and

(*c*) A right under certain conditions to re-sell the goods.

Where the property in the goods has not passed to the buyer, the unpaid seller has a right of withholding delivery, similar to and co-extensive with his rights of lien and stoppage *in transitu* in cases where the property has passed to the buyer.

A seller of goods in this connection includes any person who is in the position of a seller (e.g. an agent of the seller to whom the bill of lading has been endorsed, or a consignor or agent who is himself paid or is directly responsible for the price). A seller is deemed to be unpaid—

(*a*) When the whole of the price has not been paid or tendered, and

(*b*) When a bill of exchange or other negotiable instrument has been received as conditional payment and the condition on which it has been received has not been fulfilled by reason of the dishonour of the instrument or otherwise.

The Unpaid Seller's Lien. The unpaid seller who is in possession of the goods is entitled to retain possession of them until payment or tender of the price—

(*a*) Where the goods have been sold without any stipulation as to credit;

(*b*) Where the goods have been sold on credit but the term of credit has expired; and

(*c*) Where the buyer becomes insolvent; that is to say, where he has either ceased to pay his debts in the ordinary course of

business or cannot pay his debts as they become due, whether he has committed an act of bankruptcy or not.

The unpaid seller loses his lien thereon—

(1) When he delivers the goods to a carrier for the purpose of transmission to the buyer without reserving the right of disposal of the goods;

(2) When the buyer lawfully obtains possession of the goods; and

(3) By waiver of the lien.

Stoppage "in transitu." If and when the buyer of goods becomes insolvent, the unpaid seller who has parted with the possession of the goods has the right of stopping them *in transitu*; that is to say, he may resume possession of the goods so long as they are in course of transit, and may retain them until payment or tender of the price.

The right may be exercised either—

(1) By the seller taking actual possession of the goods; or

(2) By his giving notice of his claim to the carrier in whose possession the goods are.

Such notice may be given either to the person in actual possession of the goods or to his principal, but in the latter case, the notice, to be effectual, must be given at such time and under such circumstances that the principal, by the exercise of reasonable diligence, may communicate it to the buyer. When notice is given to the carrier, he must deliver the goods to or according to the directions of the seller, but the expenses of such re-delivery must be borne by the seller.

Re-Sale of Goods by an Unpaid Seller. A contract of sale is not rescinded by a mere exercise by an unpaid seller of his right of lien or stoppage *in transitu*. If an unpaid seller has exercised the right, and he re-sells the goods, the new buyer acquires a good title thereto as against the original buyer who is in default. There are, however, three cases in which the unpaid seller has a right to re-sell, viz.—

(1) Where the goods are of a perishable nature.

(2) Where he gives notice to the buyer of his intention to re-sell, and the buyer does not within a reasonable time pay or tender the price.

(3) Where he expressly reserves a right of re-sale in case the buyer should make default.

In cases (1) and (2) the unpaid seller may re-sell the goods and recover from the original buyer damages for any loss occasioned by any breach of contract; and in case (3), if, upon the buyer making default, the unpaid seller re-sells the goods, the original contract of sale is thereby rescinded, but without prejudice to any claim the seller may have for damages.

ACTIONS FOR BREACH OF CONTRACT.—Remedies of the Seller. Where, under a contract of sale, the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may maintain an action for the price of the goods.

Where the buyer wrongfully refuses or neglects to accept and pay for the goods, the seller may maintain an action against him for damages for non-acceptance. The measure of damages in an action for non-acceptance is the estimated loss to the seller directly and naturally resulting in the ordinary course of events from the buyer's breach of contract. Where there is an available market for the goods in question, the measure of damages is prima facie to be ascertained by the difference between the contract price and the market or current price either—

(*a*) At the time or times when the goods ought to have been accepted; or

(*b*) If no time was fixed for acceptance, then at the time of the refusal to accept.

In addition, the seller is entitled to recover special damages in any case where by law special damages may be recoverable. That is to say, if the contract was entered into with knowledge on the part of both seller and buyer that there were special circumstances attaching to it which in the ordinary course of things would produce special loss if the contract were broken, the buyer is liable to pay damages for such special loss.

Remedies of the Buyer. Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may maintain an action against the seller for damages for non-delivery.

In any action for breach of contract to deliver specific or ascertained goods, the Court may direct that the contract shall be performed specifically, without giving the seller the option of retaining the goods on payment of damages.

Where there is either a breach of warranty by the seller, or where the buyer elects or is compelled to treat any breach of a condition on the part of the seller as a breach of warranty, the buyer is not by reason only of such breach of warranty entitled to reject the goods, but—

(1) He may set up against the seller the breach of warranty in diminution or extinction of the price; or

(2) He can maintain an action against the seller for damages for the breach of warranty. The measure of damages to which the buyer is entitled is the estimated loss directly and naturally resulting in the ordinary course of events from the seller's breach of contract or warranty, and he may also recover special damages in any case where they are recoverable by law. In particular—

(*a*) Where there is an available market for the goods in question, the measure of damages is prima facie to be ascertained by the difference between the contract price and the market or current price of the goods at the time or times when they ought to have been delivered; or

(*b*) If no time is fixed, at the time of the refusal to deliver.

In the case of breach of warranty of quality, the loss to the buyer is prima facie the difference between the value of goods at the time of delivery to the buyer and the value they would have had if they had answered to the warranty.

Sales by Auction. Where a sale of goods takes place by auction as opposed to private treaty, the rules are—

(1) When the goods are put up by auction in lots each lot is *prima facie* deemed to be the subject of a separate contract of sale.

(2) A sale by auction is complete when the auctioneer announces its completion by the fall of the hammer or any other customary manner. Until such announcement is made, any bidder may retract his bid.

(3) Where a sale by auction is not notified to be subject to a right to bid on the part of the seller it is not lawful either (*a*) for the seller to bid himself or to employ any person to bid at such sale; or (*b*) for the auctioneer knowingly to take any bid from the seller or any such person, and any bid in contravention of this rule may be treated as fraudulent.

(4) A sale by auction may be notified to be subject to a *reserve* or *upset* price.

(5) A right to bid may be reserved expressly by or on behalf of the seller, and where a right to bid is so reserved, but not otherwise, the seller or any one person on his behalf may bid at the auction.

(6) The capacity of the parties to a contract of sale is regulated by the general law concerning capacity to contract and to transfer and acquire property, with this additional proviso, namely—

That where necessaries are sold and delivered (*a*) to an infant (that is, any person under 21 years) or (*b*) to a person who, by reason of mental incapacity or drunkenness, is incompetent to contract, he must pay a reasonable price for

them. Necessaries in this connection mean goods which are suitable both to the condition in life of such infant or other person, and to his actual requirements at the time of the sale and delivery.

SALES ON THE INSTALMENT SYSTEM.—Instalment credit is most usually and most fittingly applied to purchases of merchandise which are made by individual consumers at relatively infrequent intervals, on account of the durable character of the goods and their high cost. From this we get the consequence that the amount of consumer credit involved is unusually large and that a proportion of it is outstanding for a long period. Thus the risks, and consequently the costs, of the system are higher than in the case of ordinary short-term credit, so that conditions have to be inserted in the contract and precautions taken to safeguard the positions of the grantor of the credit and often of the buyer as well. There are risks of losses through granting credit to unsuitable persons, though these arise equally in the case of ordinary credit; and on account of the amounts involved in instalment transactions, greater precautions are likely to be taken. The seller can protect himself against such risks only by arranging a suitable relationship between the rate of payment and the value of the article so that the "re-possession" value is sufficient to compensate him for unexpected loss. At the same time, the buyer may protect himself, where possible, from complete loss of what he has already paid by being allowed to retain some proportion of the goods, as in the case of furniture sales.

There are two main types of instalment credit, namely—

(1) A Hire Purchase contract, and

(2) A Sale on Deferred Payment terms.

The Hire Purchase sale is a form of trade in which credit is granted to the customer on the security of a lien on the goods sold. Under such an agreement the customer takes possession of the goods at once and agrees to pay a certain sum at stated intervals. But although the goods actually come into his possession, the ownership still remains with the seller till the last instalment has been paid. On the other hand, under the system of Deferred Payments the goods become the actual property of the buyer on the payment of the first deposit, and the seller has no right to retake possession of them if the customer fails to pay his instalments, and can only sue for the amount due.

In undertaking business on the hire purchase plan, the trader should observe certain precautions—

(1) Care should be taken in selecting the class of customers with whom sales on the hire purchase system are made, otherwise extensive losses through default may occur.

(2) The period of repayment should be adjusted so that the whole value of the property is paid before it becomes worn out.

(3) The property concerned should be such that it is easy to retake possession in the event of default.

The instalment system, although convenient to trader and customer alike, possesses certain drawbacks—

(1) People may be tempted by the instalment plan to buy things which they cannot afford.

(2) It adds considerably to the price of the goods, since allowance must be made for the cost of interest and collection of instalments as well as for losses due to the defaults of customers.

(3) The fact that the trader has the right to reclaim goods under a hire purchase contract does not protect him completely from the risk of heavy loss, for the goods when reclaimed are secondhand and often of little value.

Prior to the passing of the *Hire Purchase Act*, 1938, the seller under a hire purchase agreement could retake possession of the whole of the goods sold to a defaulting customer, as well as keep by way of forfeit all the instalments which had been paid. The Act seeks to remedy this and other abuses by providing that, in case of non-payment of instalments by the buyer, the seller can no longer take the goods away against the hirer's will if the buyer has already paid one-third of the price, but must bring the matter before the County Court. The court, after considering all the facts, will decide what is to be done. Should the seller seize the goods, contrary to the provisions of the Act, then the customer can recover from him all the payments that have been made. The Hire Purchase Act, 1938, further provides—

(1) That the seller must furnish the customer with a copy of the hire purchase agreement, and before this agreement is signed the customer must be informed of the cash price of the goods in question as well as of their instalment price.

(2) Where the buyer moves and takes the goods with him, he must acquaint the seller with his new address.

The instalment agreement should be carefully studied by the buyer in order to determine whether what is intended is an out-and-out sale with payment by instalments or a true hiring agreement with an option to purchase.

TEST PAPER

1. Name the principal factors to be borne in mind by the trader when making his purchases.

2. Under what circumstances may the trader reject, on delivery, the goods which have been ordered by him?

3. Mention some of the methods by which the trader usually indicates the quality of the goods which he desires to purchase.

4. Where a seller sells goods in the course of his business to a buyer whom he knows to be buying for a special purpose, what special obligation, if any, is imposed on the seller?

5. What conditions are implied in a contract for the sale of goods—
(*a*) by description; and
(*b*) by sample and description?
A is shown a handkerchief which he is told is an "Irish linen handkerchief." A thereupon orders a dozen equal to sample. After they are delivered, A discovers that they are not real Irish linen, but that they are in every respect equal to the sample which he inspected. What is the position of A?

6. Explain how goods are sold according to analysis?

7. Distinguish *sale* from *agreement to sell*, and explain why the distinction may be important.

8. Explain the meaning attached to the following terms—
Barter; Sale; Gift.

9. What is the legal meaning of the term "Goods"?

10. Classify the kinds of goods which may form the subject of a contract of sale.

11. By what principles should the small shopkeeper be guided in his buying? When effecting his purchases, what factors must be taken into consideration besides the mere price per unit?

12. In a contract for the sale of goods, what rules determine at what time the property in the goods passes?

13. Distinguish between a "Warranty" and a "Condition."

14. "In contracts for the sale of goods, the general rule is *caveat emptor*." Comment on this statement, indicating any limitations or exceptions to the universal applicability of the rule.

15. What title does a buyer, as a general rule, acquire to the goods he purchases?

16. What rights has the seller against the buyer under a Contract of Sale?

17. What rights are, or may be possessed by an unpaid vendor of goods?

18. Explain the nature and effect of the right of *stoppage in transitu*. Under what circumstances, and by whom, can it be exercised?

19. When has an unpaid seller a right to re-sell the goods which are the subject-matter of a contract of sale?

20. What are the rights of a buyer where the seller refuses to deliver goods in which the property has passed?

21. A buyer purchases goods subject to a warranty of soundness, which is subsequently shown to be unfulfilled. What is the position of the buyer, assuming that he has paid for and taken delivery of the goods?

22. Distinguish the system of hire purchase from that of deferred payments. In what respect does the Hire Purchase Act, 1938, affect these methods of doing business?

23. Consider the hire purchase system from the standpoint of the buyer. Is this type of trade likely to extend? Give reasons for your answer.

CHAPTER XX

Organisation of the Retail Trade

NATURE OF THE RETAIL TRADE.—Under modern conditions of specialisation intervention of a number of specialist agencies is usually called for in the passage of goods from the producer to the final consumer, the last of these being the retail trader. Hence we may define the retailer as a trading intermediary engaged in the distribution of consumers' goods who is in direct contact with the ultimate consumer. In the words of the Linlithgow Committee, "The business of retailing consists in the sale to consumers of a wide variety of products which are assembled at the retailer's premises for that purpose, sufficient in variety and quantity to meet the requirements of a large number of individual households."

On the basis of these definitions we may briefly consider the particular economic functions performed by the retail trader. These may be enumerated as follows—

(1) **Holding Stocks.** The retailer holds stocks of goods ready for immediate use which he is prepared to sell in small quantities. The single household is not in a position to store large quantities of every article which comes into daily use, since this would necessitate an outlay which the majority of consumers could not face. Again, the storage facilities of the average house are limited so that purchases must be limited on this ground also. This factor appears to have been accentuated in recent years on account of the severe limitation of space in the modern "labour saving" house. Finally, as many consumable goods are of the perishable type, storage for any period of time demands special facilities, and here again, the consumer must buy in small quantities for immediate consumption. These difficulties are overcome for him by the existence of the retailer who holds stocks of goods in a shop located as near as possible to potential consumers, so that they are put to the minimum of trouble and inconvenience in satisfying their requirements.

(2) **Providing Variety of Choice.** Under modern conditions of production the majority of consumers' goods can be obtained in considerable variety, and consumers tend to differ considerably in their preferences. Here again the retailer sets himself to meet

consumer demand by assembling in his shop an assortment of goods —the products of different manufacturers—so that his clients may select what they require. Were it not for the existence of the retailer, the consumer would scarcely be able to exercise this right of choice to the extent which is now possible. The retailer's difficulties in this respect have increased considerably in recent years, since the demands of consumers for variety in the goods which they purchase have been greatly accentuated. The result has been that retailers have had to buy more cautiously and in smaller quantities, whilst at the same time they incur greater risk of loss through being left with stocks of unwanted goods on their hands. These circumstances all tend to increase the costs of retail distribution.

(3) Supplying Information to the Public. As civilisation advances men's wants increase in number and diversity with the result that production is correspondingly stimulated to meet them. Were there not some agency in existence through the medium of which goods can be displayed and demonstrated, the consumer would remain unaware of the existence of large classes of new merchandise. Again the retailer performs the service of drawing the attention of the consumer to these new goods and stimulates sales by offering facilities for their inspection. The value of this service is especially evident in the sale of such merchandise as textile fabrics, clothing or furniture.

(4) Expert Advice. Closely allied with the foregoing service is the advice which the efficient retailer can give to his clients with regard to their purchases. The retailer, by virtue of his training and experience, should be an expert in the class of goods which he handles and, as such, is competent to advise his customers. Were the latter compelled to deal direct with the producer, they would be likely to suffer inconvenience and loss on account of their lack of knowledge of what they were buying. The retailer can make good this deficiency and, indeed, must do so, since the continuance of his relationships with his customers depends in considerable measure upon his success in performing this service. He also frequently gives advice after the sale has been made, as in the case of dealers in photographic supplies.

(5) Outlet for Producers. In addition to his services to the consumer, the retailer performs a valuable service to the producer by providing him with an outlet for his goods. The manufacturer is

thus relieved of the detail work connected with distribution, and can concentrate upon production and market his product through the usual trade channels in bulk. The work of making individual sales to consumers in small quantities thus devolves upon the retailer, the separation of functions being usually conducive to greater efficiency.

(6) **Miscellaneous Services.** In addition to the foregoing, the retailer renders a wide and ever-growing range of services to the consumer. These may include free delivery of goods to customers scattered over a wide urban and suburban area. Again, extensive service may be performed by calling for orders in the better class residential districts. Credit dealing on weekly or monthly terms is another conspicuous feature of many branches of the retail trade. All of these services are sought by consumers even though they add very considerably to the already heavy costs of retail distribution.

TYPES OF RETAIL ORGANISATION.—The services which we have just examined are by no means all performed by every type of retailing organisation. Indeed, a survey of the field of retail distribution reveals the existence of organisations of widely varying types and of even more widely varying degrees of efficiency. Before proceeding further we must therefore examine the general structure of the retail trade, and attempt some classification of the various elements which compose it. In the first place, we may draw a line of demarcation between the *itinerant* and the *fixed* forms of retail trade, that is, between those traders who conduct their business from vehicles which they bring to the doors of their customers, and those who carry on trade from definite business premises. Considering the second class, i.e. the fixed retail trade, we may distinguish between small-scale and large-scale organisations. It must be admitted that this mode of division does not offer a watertight classification, but it offers a convenient basis for examination.

(1) **Itinerant Traders.** Under this heading we may include a variety of dealers, such as pedlars and hawkers, and street market traders whose common characteristic is that they usually have no fixed premises and very little stock, so that they can operate on a minimum of capital outlay. Such traders are found dealing in fruit, vegetables, and fish, and may operate as regular dealers all the year round or purely casually during a season. This type of trading is viewed with considerable disfavour by established shopkeepers who consider

that such traders offer unfair competition inasmuch as they make little or no contribution to local rates. Although this question of itinerant trading creates certain problems, such dealers give valuable service to consumers in keeping down prices, whilst they render a service to producers in clearing the market of surplus produce which would otherwise deteriorate and be wasted.

(2) Small-scale Fixed Retail Trade. Under this heading we must place all traders who conduct their business from a properly-established shop, but whose turnover is restricted to a relatively small amount. A striking feature of the modern distributive system is the large number of small establishments engaged in the retail trade. In 1950 there were over 531,000 retail shops in Great Britain making sales of nearly £5,000 million per annum. Of these certainly more than 80 per cent are small units, some 10 per cent multiple stores and about 1,000 are departmental stores, the remainder being retail co-operative societies. These shops employed some 2¼ million people full and part-time.

The reason for the prevalence of the small retail business is not far to seek. It is possible to establish such a business with a very small capital outlay either by converting the front room of an ordinary house into a shop, or by renting a small shop with the private residence attached. In such circumstances, the rent of the premises may come to little more than the rent of a private dwelling-house. Expenditure on fittings and fixtures can be reduced to a minimum, whilst stock can usually be obtained from a wholesale house on favourable credit terms. Finally the proprietor enlists the services of his wife and family for the purpose of running the business, thereby saving the payment of wages to assistants. Indeed, he himself may continue to work at some other occupation and treat the shop as a spare time employment designed merely to supplement his income.

Such a business comes into existence very easily and, it may be added, disappears easily and frequently, only to be replaced by new ventures. A large number of these concerns are, moreover, highly inefficient. It may be argued that the existence of so many sources of supply sets up keen competition, leading to a reduction of selling prices to the consumer. Yet, a large proportion of such establishments work under the disability of excessive costs which render them powerless to provide the real and effective competition

capable of reducing profit margins. The average small shopkeeper has not, and cannot hope to create, a sufficient turnover to yield him a satisfactory income without charging his customers, directly or indirectly, more than his services are worth. Again, many of the services which we have enumerated as being rendered by the retailer are performed only indifferently by traders of this class. The small retailer has a function, and a very valuable one, to perform in the field of distribution, but the existence of widespread inefficiency acts as a barrier to progress.

(3) Large-scale Fixed Retail Trade. In contrast with the small-scale retail undertaking we have those which characteristically conduct their operations on a large scale. In their origins, these large retailing businesses usually spring from the small types which we have just considered, and the form which they have taken is very largely dictated by external economic conditions. It may be, for example, that a retailer dealing in one line of goods, such as drapery, finds that he can attract a large number of customers for that particular class of merchandise. In order to increase his turnover he decides to add another class of goods and opens a new department for this purpose. In this way we have the evolution of the *Departmental Store* which, in its developed form, brings together in one building a large number of consumers' goods classified on the basis of department. Retail expansion may, however, take another form. The trader dealing in a single line of goods who finds his turnover expanding may be unwilling to add new lines of goods to stimulate business further, but prefer to develop the existing business. If he confines his business to one building there will be a limit to his increase of turnover, and in order to overcome this difficulty, he opens branches in selected districts, stocking the same lines of goods as the parent shop. In this way we get the development of the *Multiple Shop* or *Chain Store* systems, i.e. the type of business handling a limited range of goods but selling through a large number of retail outlets.

The true multiple shop deals only with one type of goods in its branches. It is common in the grocery trade and in tailoring. Stores like Woolworths, Marks and Spencers and Boots which have many branches and sell a variety of goods in each branch are multiple-departmental stores. They combine the characteristics of both types of organisation.

On an entirely different basis we have retailing organisations controlled by consumers themselves in the *Co-operative Retail Societies*. These organisations differ from those previously mentioned not so much in external organisation or internal administration as in control and direction. The "capitalistic" undertaking represented by the foregoing types is controlled by managers and directors who are responsible to the shareholders who are the real owners of the business, and who take the profits which result from its operations. On the other hand, the co-operative undertaking is controlled by managers and directors who are appointed by and responsible to the members, who are themselves the customers of the undertaking. In these organisations, over 98 per cent of the total trade done is with customers who are members and therefore part-owners of the organisation. The surplus resulting from such trading is distributed amongst members in proportion to their purchases, after a fixed rate of interest has been paid on capital.

A further type of retail organisation which is usually considered to be of the large-scale type is the *Mail Order business*. In this case we have a type of business where the "personal" contact between the seller and his potential customer is made through some form of advertisement—usually press advertising supported by direct mail. Since the customer cannot visit the business premises and make a personal examination of the goods, considerable expenditure has to be incurred in the preparation of the descriptive advertising literature, which, in most cases, must be carefully illustrated. The mail order business is of value in bringing a wide choice of goods before customers who are precluded by reason of distance from visiting big shopping centres. In this country, however, owing to the fact that few people are at any great distance from a shopping centre, the business has not developed to the same extent as in the United States. There are few examples of the "pure" mail order business in this country, and the most successful appear to be carried on as a special department of the departmental stores.

THE SMALL SHOP.—In our survey of the general structure of the British distributive system we have already commented upon the fact that the small family shop is the predominant type of trading unit. *These small shops are of two general classes.* There is, first of all, what we may term the *General Shop*, that is, a shop of the general utility type whose proprietor does not restrict his stocks to

any particular line of goods but stocks whatever his experience has told him that his customers are likely to require. There are obvious limits to which such diversification of stocks can be carried, but the usual class of goods is the consumers' goods which are in every day domestic use and where patronage may be secured on account of convenience. This is especially the case with branded goods where, assuming proper conditions of storage, quality and price are the same wherever purchases are made. These branded goods are usually extensively advertised by manufacturers or wholesalers and sold to retailers at a fixed margin below the advertised retail price. In respect of these goods the retailer has to make little selling effort; they have been pre-sold by the advertising, and the retailer is merely a stockist who must know the right levels of stock to hold. The second type of small shop is what has been termed the *Specialty Shop* where specialisation on one line of goods takes place. Such shops as these are found in the established shopping centres rather than scattered amongst dwelling houses as are those of the first class. Thus we may have shops concentrating on the sale of millinery, men's or women's wear, jewellery, boots and shoes, or furniture. In the case of such shops as these, the proprietor usually relies upon his special knowledge of the goods to give such service to his customers as to compensate them for the higher prices which he is compelled to charge. Here again he frequently differs from the proprietor of the first class of shop, whose knowledge of the goods he sells is frequently very poor.

The question of the survival of the small retailer in the face of the competition offered by large-scale retailing organisations is one which has often been debated. In the first place, as we have already seen, the ease with which the small shop of the "general" type can be established is likely to militate against any great reduction in numbers. Again, the convenience which the small shop can offer to the consumer buying from hand to mouth is yet another factor working for its survival. Furthermore, we have to take into consideration the factor of the personal contact between shopkeeper and customer which is much more easily achieved and productive of better results in the small shop than in the large organisation. There is a certain degree of "consumer snobbishness" which is gratified by the personal attention of the small shopkeeper and his knowledge of personal idiosyncrasies.

The

RETAILER'S ACCOUNTS

Kept on Double Entry Principles are found in

DAY BOOKS
(a record made as the Transactions Occur)

- **Purchases Book**
  Entered up from Invoices as received from Suppliers after Checking.
- **Sales Book**
  Entered up from Vouchers made out by the Salesmen in the Shop.
- **Returns Books**
  Entered up from the Debit or Credit Notes Issued and Received.
- **Cash Book**
  Entered up by Cashier when Cash is Received or Paid.

LEDGERS
(a classified record of Personal Accounts, Property Accounts, Income and Expense Accounts)

Entered up by Ledger Clerk in the Office from the Day Books in order to show

(a) Accounts Owing to the Business.
(b) Amounts Owed by the Business.
(c) Expenses of Selling.
(d) Turnover and Takings.
(e) Capital of the Proprietors.
(f) Profit Earned.

THE RETAILER'S STATISTICS.—In order that the retailer may exercise effective control over his business, it is essential that he shall keep systematic records of all business transactions. The starting point of these records is, of course, the financial accounts which, in order to be of the greatest possible value, should be kept on double-entry principles. These records may be made to yield much valuable information on such matters as the following—

(1) The total liabilities of the business to trade suppliers and others, together with the amount owing to each individual.

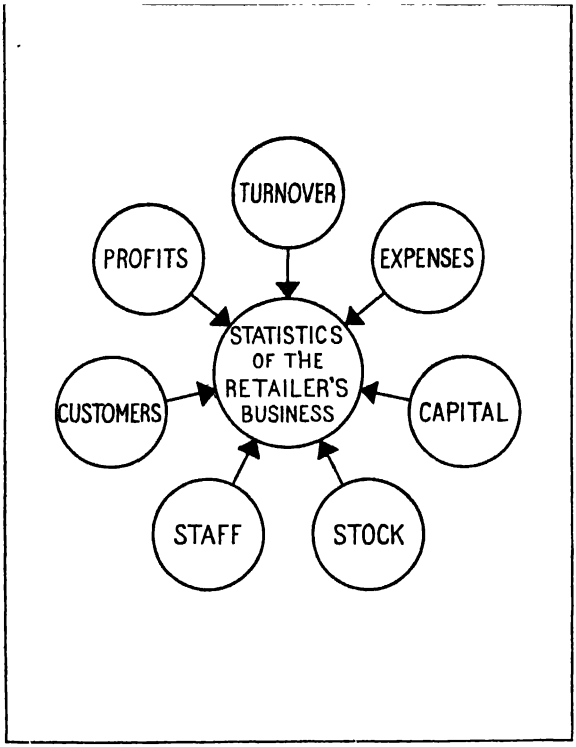
(2) The total amount due to the business from debtors and the amounts due from individuals, together with the period of time for which each account has been outstanding. This information is of considerable importance in forming decisions with regard to the granting of new credit.

(3) The turnover of the business and the expenses incurred in making that turnover.

(4) The various items of property held by the business in the form of fixed and circulating capital, together with a statement of the trader's capital account.

The information obtained on the basis of these accounts will in all probability be sufficient to meet the needs of the small retailer. As the business increases in size, however, more detailed information becomes essential for the effective administration of the business. When the undertaking comprises a large number of departments or branches, highly complex problems of financial control arise, and at this stage statistical control must be employed to supplement the information yielded by the financial books. It may be emphasised that these latter still form the basis of the greater part of the business statistics, but the aim of the statistical method is to show clearly the causal relationships which exist between the various parts of the undertaking. The financial records, which deal with many of the figures in bulk, are analysed in detail in order to reveal latent tendencies. On the basis of such analyses, graphs and charts may be prepared to illustrate such matters as the relation of the purchases to the selling price, the ratio of expenses to sales, the ratio of profit to capital invested, and so on. By the use of such devices the data relevant to a particular business problem may be more readily grasped by those responsible for business administration.

BASIS OF THE RETAILER'S STATISTICS



The chief accounting figures utilised in the compilation of the retailer's statistics are shown in the diagram above. They include the figures of turnover, expenses, the capital employed in the business, the average stock kept in the warehouse, the wages and expenses of the staff, the amounts owed by customers and the net profit. From these data, a variety of decisions may be taken affecting such matters as purchasing and advertising policies, the extension or the elimination of particular departments, and the best utilisation of staff. Amongst other things, statistical control confers the following advantages on the retailer—

(1) It gives him an accurate insight into the composition and the fluctuations of his turnover.

(2) It provides him with a detailed analysis of expenses so that he may control them effectively.

(3) He may compute, with a considerable degree of precision, the speed of stock turnover, either in bulk or in respect of particular lines.

(4) He can form a reliable estimate of the relative efficiency of the staff in the different departments or branches.

(5) Statistics compiled on a uniform plan may be employed as a basis of comparison with other undertakings in the same trade.

Turnover. This is one of the most important figures connected with the retailer's business since it is one of the main factors upon which net profit depends. It may be defined as the amount of the net sales of the business during a trading period. The amount of the turnover, based upon the selling prices, may be arrived at as follows—

	£	£
Total Cash Sales	**15,000**	
Less **Returns and Rebates**	**100**	
Net Cash Turnover		**14,900**
Total Credit Sales	**30,000**	
Less **Returns and Rebates**	**1,900**	
Net Credit Turnover		**28,100**
Total Turnover		**£43,000**

These figures show the total turnover of the concern for the whole of a trading period, but in order to obtain the greatest value from them, it will probably be necessary to prepare an analytical statement showing how the turnover is distributed between the departments of the business, and also possibly over the months of the year. If only the total figures are considered, a very misleading impression may be gained. There may, for example, be a highly satisfactory increase in the total turnover, but further analysis may show that this is due to one or two departments, and that other branches of the business are losing ground. Such a table may be constructed on the lines shown on page 192, on the supposition that the business comprises three departments. These turnover figures compared with cost of goods sold will show the relative profitability of the departments. The figures of turnover, if ascertained daily or monthly, may be shown in the form of a graph which may be used to illustrate—

(1) The course of sales during the month. It would show the effect of pay days and holidays on the turnover of the business.

(2) The state of the turnover in comparison with that for the same month of the previous year.

TOTAL TURNOVER ANALYSED DEPARTMENTALLY

Month	All Departments			Department A			Department B			Department C		
	Cash Sales	Credit Sales	Total	Cash Sales	Credit Sales	Total	Cash Sales	Credit Sales	Total	Cash Sales	Credit Sales	Total
	£	£	£	£	£	£	£	£	£	£	£	£
January	2,110	1,742	3,852	1,010	890	1,900	780	640	1,420	320	212	532
February	1,943	1,440	3,383	965	740	1,705	698	520	1,218	280	180	460
March	1,732	1,357	3,089	860	675	1,535	612	517	1,129	260	165	425
April	1,628	1,368	2,996	780	698	1,478	608	496	1,104	240	174	414
May	1,510	1,250	2,760	715	620	1,335	595	420	1,015	200	210	410
June	1,481	1,115	2,596	710	615	1,325	496	320	816	275	180	455
July	1,501	1,284	2,785	726	608	1,334	515	480	995	260	196	456
August	1,761	1,475	3,236	825	750	1,575	620	475	1,095	316	250	566
September	1,682	1,350	3,032	780	620	1,400	612	520	1,132	290	210	500
October	1,545	1,276	2,821	820	540	1,360	505	496	1,001	220	240	460
November	1,708	1,501	3,209	840	780	1,620	570	456	1,026	298	265	563
December	2,130	1,760	3,890	1,010	890	1,900	820	580	1,400	300	290	590
Total	£20,731	16,918	37,649	10,041	8,426	18,467	7,431	5,920	13,351	3,259	2,572	5,831

(3) The effects of advertising campaigns and special bargain sales.

(4) The effects of unknown influences which call for further investigation, since they may arise from causes within the business which may be eliminated.

Expenses. In a small retail business it may be a matter of some difficulty to arrive at a correct assessment of business expenses on account of the peculiar conditions under which the concern is carried on. As we have already seen, the small retail shop is frequently conducted on a "family" basis, and the proprietor's dwelling-house and shop are often on the same premises. If the premises should be rented, it should be a fairly easy matter to apportion the rent so that a fair charge is made against the profits of the business in respect of this expense. If the proprietor owns the premises himself, he should again make an estimate of their rentable value and charge this sum against the profits. Again, if he or his family give service to the business, some allowance should be made in respect of this work, since if it were necessary to engage the services of an outside person, the expense of so doing would be chargeable against the profits.

These considerations are mainly applicable to small retail businesses and do not arise in the case of large concerns where business is conducted on a much more formal basis. In the latter case, however, the question of expense control and determination assumes formidable dimensions and becomes a problem of first-class importance. In a large concern there appears to be an inherent tendency for expenses to mount up which, unless carefully checked, must result in a serious diminution of trading profits. The first requisite of efficient expense control is a careful classification of expenses in order to secure uniformity. Expenses in such a business should as far as possible be allocated between departments in order to assess relative profitability. Accurate comparison of the expenditure under a given heading becomes impossible if certain items are sometimes included and sometimes omitted. Thus, under the heading of "Dispatch Expenses" it may be decided to include the following items—

Packing Materials Used	**Garage Stores**
Carriage	**Hire of Vans**
Parcel Postage	**Drivers' Expenses**
Motor Licences	**Motor Repairs**
Motor Insurance	**Painting Vans**

In the absence of such a definite classification, "Motor Insurance" might sometimes be included in the above, and sometimes under "Insurance."

The
RETAILER'S CAPITAL
consists of

Owner's Capital	**Outside Capital**
(a) Original Capital invested in the Business.	(a) Loans introduced by the Proprietors, e.g. by a Partner or Director.
(b) Reserves created out of Profits, e.g.— 1. Bad Debts Reserve. 2. Taxation Reserve. 3. General Reserve.	(b) Mortgages.
(c) Profits left in the Business.	(c) Bank Credit— 1. Loans. 2. Overdrafts.
	(d) Bills Payable.
	(e) Trade Suppliers.

Capital. As shown in the accompanying diagram, the capital of a business is derived from two sources, namely, that which is supplied by the proprietors themselves, either in the form of their original investment or of undistributed profits, and that which is provided by outside persons. In the latter case, capital may be provided in a number of ways, such as by a member of a partnership firm lending money to the business as distinct from investing capital in his capacity as part proprietor. Again, money may be borrowed, with or without security from friends, or by the mortgage of property. It may also be raised by way of a loan or an overdraft from a bank, though in this case, security will in all probability be required. Finally, a very important source of outside capital is provided by trade credit, extended to the retailer by wholesalers and manufacturers. Such traders, by allowing the retailer to control and dispose of stocks of goods for which he is expected to pay at some defined time in the future, in effect place some of their working capital at his disposal.

The capital secured from these various sources is, of course, represented by the assets held by the business, and it is essential

that close control be exercised over the composition of these assets. It must be the aim of the retailer to employ his resources in the most remunerative way possible, and yet at the same time meet his commitments as they fall due. Hence, he will have to keep a cash balance sufficient to meet the claims of trade creditors, to pay the wages and salaries of the staff, and to meet other expenses as they fall due. At the same time he must remember that cash in the till or on current account at the bank is an unremunerative asset and therefore must be restricted as far as possible. The annual accounts will, of course, give the desired information regarding the composition of the retailer's capital, but it is necessary that the position should be known with certainty at more frequent intervals, particularly in a business of any size. In order to give this information, a statement on the lines of the example shown on page 197 may be submitted to the proprietors or directors at convenient intervals—usually every month.

Stock. An important class of statistics is concerned with the control of stocks of goods held by the trader. These usually represent a substantial part of the retailer's working capital, and it is essential that they should be under proper control in order to reduce losses and wastage to the minimum. A knowledge of the average stocks held in a business is necessary if we wish to calculate the *speed of turnover* of stocks. We have already defined turnover as the net sales made during a trading period, and if this figure be compared with the average stock of goods at sale price, held by the dealer during the period, we can find how many times the stock has been turned over in the period in question. This forms a valuable index of the efficiency of business operations. A rough approximation of the value of the average stock at selling price may be obtained by taking the average of the opening and closing stocks for the trading period. Thus, if the stock on 1st January were £500 and that on 31st December were £600, the average stock by this method would be £(500 + 600) ÷ 2 = £550. This figure may not be very accurate since the stock at the end of a trading period may not be an accurate reflex of stocks during the period. In many retail businesses, stocks will be deliberately reduced at the end of the period in order to relieve the burden of stock-taking. A more accurate method may be based on the average of the monthly figures as follows—

		£
Total Stock on	31st January	220
" "	28th February	300
" "	31st March	290
" "	30th April	250
" "	31st May	290
" "	30th June	320
" "	31st July	310
" "	31st August	300
" "	30th September	280
" "	31st October	250
" "	30th November	260
" "	31st December	240
		£3,310

Average Stock $= £\frac{3310}{12} = £275$

Hence, if it is found that the annual turnover in this case is £8,250, then the rate of stock turnover is $\frac{8250}{275}$ or 30 times per annum. In other words, stocks are being held for an average of 12 days between receipt and sale. This rate should be maintained or improved if possible. A fall in the rate means stocks are "sticking," and this will have a serious effect on earnings and profits.

Information is now gradually becoming available as to what constitutes "normal" rates of stock-turn for particular trades, so that these figures offer an objective index of efficiency. Further, in the case of a departmentalised concern, comparisons may be made between departments, or of experience in different years, on the following lines—

TURNOVER OF STOCKS

Year Ended 31st Dec., 1956. With Comparative Figures for Previous Year

Department		Sales	Average Stock at Selling Price	Stock Turn per Annum	Target for Year
		£	£		
	1955	1,300	240	5·42	
A. Drapery	1956	1,500	255	5·88	6
	1955	2,500	1,200	2·08	
B. Furniture	1956	3,500	1,500	2·33	2½
	1955	8,100	800	10·13	
C. Grocery	1956	9,000	850	10·59	10
	1955	11,900	2,240	5·31	5·3
Total	1956	14,000	2,605	5·38	

FINANCIAL STATEMENT

as on 30th November, 19..

		£	s.	d.	£	s.	d.
1. Cash Statement—							
Cash on Hand		41	10	6			
Bank Balances—							
(a) Current Account		1126	3	2			
(b) Deposit Account		3678	8	6			
		£4846	2	2			
Total					£4846	2	2
2. Approximate Receipts for Coming Month—							
(a) On Bills Receivable					976	–	–
(b) On Ledger Accounts					3960	–	–
(c) Other Sources					28	–	–
Total					£4964	–	–
		£	s.	d.	£	s.	d.
3. Commitments for Coming Month—							
(a) On Bills Payable		520	–	–			
(b) On Accounts Payable		1210	2	6			
(c) Operating Expenses—	£						
(1) Wages and Salaries	210						
(2) Rent and Rates	130						
(3) Debenture Interest	80						
(4) Miscellaneous	20	440	–	–			
		£2170	2	6			
Total					£2170	2	6
4. Value of Stocks—							
Department A					380	–	–
,, **B**					960	–	–
,, **C**					450	–	–
,, **D**					280	–	–
Total					£2070	–	–
5. Overdue Accounts—							
Wm. Buyers					25	–	–
Owen More					60	–	–
Sundry small a/cs.					10	–	–
Total					£95	–	–

Signed *John Smart,*
(Secretary)

Staff. A large retail concern will keep careful records relating to staff matters, giving details as to the numbers employed in the various sections of the business; for example, in the different selling departments, the workshops, the administration, and the auxiliary staff. In this way a check may be kept upon unnecessary staff expansion by transferring assistants from one section to another where this is possible. At the same time, a comparison may be made between the staffs and the turnover of each department and provision made for extra staff when the need arises. Again, statistics may be compiled with regard to the costs and results of salesmen in order to ascertain those who are worthy of promotion, and to eliminate those who cannot attain a reasonable standard. Such statistics as these involve an analysis of sales so as to obtain the figures for each assistant, but this will be necessary in any case where commission is paid.

Profits. The net profit of the business will be ascertained from the retailer's profit and loss account, due regard being paid to such matters as the remuneration of the proprietor, and an allowance for rent when he occupies his own premises. The net profit may be expressed as a percentage of the turnover for purposes of comparison with other periods.

MODERN TENDENCIES IN THE RETAIL TRADE.—The structure of retail trading underwent considerable modification between the two Wars, though, as already indicated, the standard of efficiency is still low on the whole. Yet the need for efficiency in retailing is greater to-day than ever in the past. About three-fifths of the articles sold through retail shops in the United Kingdom fall in the category of food and perishables. In connection with many of these —for example, milk, eggs, bacon, and meat—primary producers have formed *marketing boards* with wide statutory powers, and the impact of these organisations on the retail distributor has made itself felt. If the distributor is to hold his own he will have to organise as well.

It is, of course, true that there has been a tendency for large-scale organisations, such as departmental stores and multiple shops, to increase their share of the total trade at the expense of the small trader. These organisations are introducing scientific methods in the sphere of retail distribution with a consequent increase of efficiency. There is, none the less, ample scope in the retail trade

for the small trader who knows his business. Again, the advance of the consumers' co-operative movement has caused considerable concern of recent years to private trading interests.

In addition to the foregoing considerations, however, the character of the retail trade has been affected by the following developments—

(1) **Branding Goods.** A growing number of goods which at one time were sold in bulk are now sold ready packed under a special name. The practice of branding was introduced by manufacturers who desired to develop national distribution of a commodity with the aid of national advertising. In this way the individuality of a product may be established with the result that a higher degree of control over prices, demand, and trade channels may be established than would otherwise be possible. Where a manufacturer deals in branded goods, his advertising can be linked definitely with his own product so that consumer demand is created, not for, say, tobacco in general, but for a stipulated brand of tobacco. In this way retailers and wholesalers are compelled to hold stocks in order to meet the consumer demand, whilst at the same time the retailer loses some of his power to influence the demand of customers. Such goods usually carry a smaller margin of profit to the retailer than is the case with unbranded goods, the argument being that they are more easily handled by the retailer.

Competition between manufacturers has, however, brought into existence in the case of most commodities rival brands of merchandise, which, from the standpoint of the consumer, differ little one from the other. The proprietors of the rival brands attempt to establish them by expensive advertising campaigns, with the result that the cost of advertising has shown considerable increase since the first World War. At the same time the difficulties of the retailer are increased since he has to stock a number of lines in order to cater for the varying demands of his customers. The general confusion has been further intensified by the fact that many wholesalers and large retailers have introduced private brands which they sell in competition with those of the manufacturers. Such goods can generally be bought more cheaply than branded goods which are nationally advertised, so that larger margins of profit can be realised. Secondly, in the case of a wholesaler, such brands give a greater sense of security. He may work up a business for a manufacturer and then have it taken away by a decision of the latter to sell direct

to retailers. If the wholesaler has his own private brand this cannot occur.

(2) Price Maintenance. Closely allied with the development of the sale of branded goods in the retail trade is the vexed question of resale price maintenance. Branded goods which are widely advertised are almost invariably price maintained, the retail selling price figuring in the advertisements. Amongst the trades in which the system is most prevalent are books, newspapers and periodicals, stationery, drugs, photographic goods, gramophones and records, motors and cycles, tobacco and cigarettes, confectionery and groceries. It is less widespread in the drapery and clothing trades. Some trades, especially those which handle fashion goods or highly perishable goods, are scarcely affected.[1] A retailer may use well-known proprietary articles as "leading lines," hoping that, by selling them below the standard price, he will attract custom to his shop for other goods. Such a practice immediately antagonises the neighbouring retailers who find their sales falling off. This may lead them either to cut prices in competition or to discontinue stocking the line in question, so that the manufacturer's sales fall off.

In order to enforce the observance of the retail prices fixed by him, the manufacturer usually employs persuasion in the first place, then the threat of withholding supplies, and finally the actual withholding of supplies. The last course of action is one which is not always easily taken since often the channels of distribution are so complicated that the source of supplies cannot be located. In consequence, in certain trades manufacturers have combined in associations for the purpose of detecting and suppressing price cutting. Such associations are in existence in the drug, publishing, stationery, motor, grocery, and tobacco trades. In so far as this policy of price maintenance can be enforced, competition in such articles in the retail trade ceases to be on a basis of price, so that the profit margin of each retailer will depend on his efficiency in reducing costs.

(3) Self-service. The increasing difficulty of obtaining shop staff in these days of full employment, and the increasing cost of such labour, have led to the development of this form of retailing. It reduces the retailer's overheads, once installation cost has been absorbed, and

[1] Report of Committee appointed by the Lord Chancellor and the President of the Board of Trade to consider Certain Trade Practices.

pleases the customers since it considerably reduces waiting time. In this type of organisation the goods are set out on shelves or stands, and the customer walks round the shop and picks out the goods he or she requires. Sometimes a special basket is supplied which the customer can take round and into which the goods can be put as they are selected. When the customer has taken all the goods required he or she passes a cashier who checks and prices the goods taken and obtains payment for them. It is necessary to have staff available to stock and replenish the shelves or stands and to advise customers if necessary, but if all goods have to be selected and handled by shop assistants then considerably more staff would be required.

This system has been most used in the grocery trade but is now being extended into a number of other trades. Obviously it lends itself best to the type of business where goods can be pre-packed, weighed, labelled and priced.

TEST PAPER

1. Show, by taking the grocer as an example, what are the functions of the retail trader.

2. Give examples of different types of retailers to be found in modern business and explain the nature of the services they render to the home manufacturer.

3. It has been stated that the only function remaining now for the small trader is to open up in a new district with a growing population and to develop business which he is destined to lose in a short time to multiple shop firms and central department stores. Discuss this view, and set out what you yourself consider the proper sphere of the small shopkeeper in modern trade.

4. What are the types of organisation engaged in the retail trade? Give a detailed account of any one of them and state how it is specially organised to satisfy public demand.

5. A retail trader usually carries stock which costs him £2,500. He turns over his stock four and a half times a year and he makes 20 per cent gross profit on sales. His total expenses usually amount to £1,900. Find his annual gross profit and his annual net profit; and express each as a percentage of his turnover.

6. A retailer has premises valued at £4,500 and stock which cost him £2,500. He owes £600. He turns over his stock four times each year, making 20 per cent gross profit on his sales each time. His expenses amount to £750 for the year. What percentage does his net profit bear to his capital?

7. The ratio of total expenses to sales taken over a period of a year is sometimes referred to as the "Operating Ratio." Consider how far its fluctuations year by year can be taken as indices of the progress of a retail business.

8. Outline the chief outstanding statistical facts which, in your opinion, are vitally important to a large retail business and by which its yearly progress can best be examined and adjudged.

9. Discuss the advantages and disadvantages of "branded" goods in retail trade. Why do traders often sell goods under their own private brands when it is evident they are not manufacturers?

10. It has been stated that "the policy of price maintenance imposed by

manufacturers on retailers is of little importance." Do you agree? Argue the points involved.

11. Discuss the effect upon the retail trade of the increase in proprietary articles sold at prices fixed by the manufacturers.

12. Discuss the reasons for the increase in the average size of the retail business unit, and indicate the advantages and disadvantages of this trend.

13. What is "self-service" in retailing? Why has it come about, and what limitations on its development can you suggest?

CHAPTER XXI

Transactions in the Retail Trade

BUYING IN THE RETAIL TRADE.—The retail dealer assembles a stock of goods from which his clients may select their requirements, whilst the retailer himself obtains his stock either from the original producer or from some form of wholesaler. In a later chapter we shall examine the various channels through which goods may pass from producer to consumer, but for the moment we may regard these two as the principal sources of supply, whilst in the case of the small retail trader the wholesaler is the most important. A retailer of the type we are considering, upon establishing himself in business, will wish to get into contact with one or more wholesalers who can supply his requirements. This he may do by making a written application for their price lists and terms of sale, but before he has been in business long he will be waited upon by travellers of manufacturers and wholesalers who are active in the district. These will supply him with price lists and show him samples of the goods which they supply and will also take orders. In most cases where branded articles are being sold the supplier will state in the list not only the wholesale price to the retailer, but also the minimum selling price which must be charged to the consumer. This system of "price maintenance," as it is termed, is employed to prevent one dealer undercutting another in the sale of proprietary articles. In these price lists will also be found the conditions of sale of the wholesale house covering such matters as discounts, time of payment, mode of delivery, and similar matters.

In some trades, however, it may not be possible to draw up a standard price list on these lines, or if such a list can be supplied, the requirements of the trader may necessitate special treatment. Thus, he may be buying exceptionally large quantities, or he may require some special mode of packing. In these circumstances, the trader will address a special inquiry to the wholesale house asking for a special *Quotation*. This may be described as a particularised form of price list and comprises a statement of the price and terms upon which certain articles can be supplied. In somewhat the same category is the *tender* or estimate which may have to be submitted

by a supplier. This method of obtaining prices for supplies of goods is usually adopted by large commercial buyers and public authorities. They will usually insert advertisements in the Press inviting tenders for certain classes of goods, the tenders having to be made on official forms. These tender forms usually state in detail the conditions of contract and specify the nature of the goods to be supplied. There is no binding contract until the tender has been accepted.

Reverting now to the procedure of the retailer who is considering the purchase of goods for stock we may assume that he is in possession of prices upon which he can base his *Order*. Before placing the order with the supplier he will have to decide what quantities of goods he is to order, and his decision will be influenced by—

(1) The warehousing accommodation which is available.

(2) The speed with which the goods can be sold—a matter which must be settled either by his past experience or by his estimate of the possibilities of the market.

(3) The durability of the product in view of the storage conditions which he can provide.

(4) The length of time which it will take to obtain new supplies.

(5) The terms which the supplier offers for orders of varying size.

In purchasing supplies the last factor is frequently allowed to exert an undue influence on the mind of the retailer who may be tempted into a policy of over-buying on account of the possibility of securing quantity discounts or "bargain" prices. This is a fatal mistake, for if goods are purchased in quantities which are too large, not only is an excessive amount of capital locked up in them, but the trader is exposed to the risk of loss due to physical deterioration or on account of changes of fashion. On the other hand, if goods are bought in quantities which are too small, there is a danger of running out of stock, which results in loss of custom and injury to goodwill. A further question which may have to be settled in the case of packaged goods is the size or sizes of package which shall be ordered. The makers may pack the goods in half a dozen different sizes, but it does not follow that all of these will be in equal demand amongst the retailers' customers. Here again is a matter in which experience is the only reliable guide.

When the trader has settled these preliminaries in his own mind, he can then proceed to order the goods. All orders should be given in writing and a copy retained, the usual practice being for the small

SPECIMEN ORDER FORM

ORDER

No. A 397

Telephone: Cardiff 432

A. SMALLMAN AND SON
Retail Grocers and Provision Dealers

21 City Road,
Cardiff.
24th October, 19 .

The Wholesale Grocery Supplies, Ltd.,
17 *Eastcheap, London, E.C.3.*

Please supply the following goods—

1 *gross small packets "Excelsior" Shredded Beef Suet* @ 29/- *per gross.*

2 *doz.* 1 *lb. Jars "Radion" Brand Apricot Jam* @ 16/6 *per doz.*

2 *doz.* 2 *lb. Jars "Radion" Brand Greengage Jam* @ 22/6 *per doz.*

Terms: *Net cash,* 30 *days.*

Delivery: *Earliest, to above address.*

For and on behalf of
A. SMALLMAN & SON.
T. Smallman,
(*Manager*)

Please note—

No order will be recognised unless given on our official order forms and duly signed.

We reserve the right to reject any goods which are not in accordance with the description given above.

An advice note should be sent with every consignment.

The number of this order should be quoted on all invoices.

trader to use a *Duplicate Order Book,* in which a copy of every order is made by means of a carbon paper, the original being torn out and sent to the supplier. Each order and copy are numbered serially so that by quoting the order number and date, adequate reference may be made to any order. The order will be made out on the lines indicated in the specimen given on page 205. Care must be taken that in all cases full details of the quantities, price and description of the goods are given together with any special instructions as to packing and delivery.

Upon receipt of the order, the wholesale house will send a formal acknowledgment, thanking the retailer for the order and probably giving some indication of when delivery may be expected. In the case of an opening order the wholesale firm will require to know something of the standing of the retailer before opening a credit account with him. The retailer may have given trade references in which case these will be investigated before the goods are sent. If no references have been given, a status inquiry may be sent to a *Trade Protection Association* or a tactful letter may be addressed to the trader pointing out that, as this is a first transaction, it is customary to ask for trade references. When these preliminaries are settled, the goods are prepared and dispatched. They may be sent either in the wholesaler's own vehicle or by an independent carrier. In either case, when the goods are delivered, the retailer will be required to sign some form of delivery book or *Delivery Note,* stating that the goods have been received. As there is usually not time to make a proper examination of the consignment immediately on arrival, many persons mark the sheet "not examined" with the idea of leaving the way open for making a claim should this prove necessary. In any case, the recipient of the goods does not lose his right to reject damaged or unsuitable goods until he has had a reasonable opportunity of examining them. Many firms draw the attention of their customers to the need for prompt notification of damage to consignments by printing on their *Advice Notes* or *Invoices* some such clause as the following—

No claim on account of short delivery, damage in transit, or other causes will be admitted unless made within four days of delivery of these goods.

On the same day as the goods are dispatched by the wholesaler he will send an *Advice Note* to the retailer informing him that the goods, which are specified in detail, have been dispatched to him

SPECIMEN INVOICE

INVOICE

26th October, 19. .

Bought of

THE WHOLESALE GROCERY SUPPLIES, LIMITED

17 EASTCHEAP,

LONDON, E.C.3.

Messrs. A. Smallman and Son,
21 *City Road,*
Cardiff.

Order No. A397   Per *Rail*   Carriage Paid

				£	s.	d.
	1	*gross Small Packets "Excelsior" Shredded Beef Suet per gross*	29/–	1	9	–
	2	*doz. 1 lb. Jars "Radion" Brand Apricot Jam per doz.*	16/6	1	13	–
	2	*doz. 2 lb. Jars "Radion" Brand Greengage Jam per doz.*	22/6	2	5	–
				5	7	–
E. &	O.	E.				

Net Cash, 30 days.

and indicating the mode of transport employed. Alternatively the Advice Note may be dispensed with, and an invoice on the lines of the example on page 207 sent instead. The invoice should show details of the quantities, descriptions, and prices of the goods, together with any trade discounts which may be allowed. Reference should be made to the number of the customer's order and also to any special terms of payment, cash discounts, etc. The distinction between trade and cash discount has already been referred to on page 167. Finally, if the invoice is being used as an Advice Note, a reference to the mode of delivery will be necessary. Upon receipt of the goods they will be checked with the invoice and also with the original order so that any material discrepancies can be brought to the notice of the supplier and a claim entered. If any charge has been made on the invoice to cover cost of carriage, reference should be made to the wholesaler's conditions of sale to see whether this is in order. Generally speaking, most wholesale houses pay carriage on all orders over a certain value, and an attempt should be made whenever possible to give an order sufficiently big to avoid payment of carriage.

Any adjustment which may be necessary between buyer and seller on account of some mistake in the original invoice, or of a claim made for damage or unsatisfactory goods, may be made in one of two ways. The supplier, having agreed to the claim may submit an amended invoice which supersedes the first. More usually, however, he will make the correction by sending a *Credit Note*. Thus, we will assume that the wholesaler undertakes to pay carriage on all orders valued £5 and over, but has by oversight charged carriage on an order for goods exceeding this value. He will then send out a credit note in the form shown in the example on page 209, this document usually being printed in red ink so that it may readily be distinguished from an invoice.

At the end of each month, or sometimes at the end of each quarter, the supplier will send out a *Statement of Account* which shows in summary form the state of indebtedness between the two firms. The dates and amounts of each consignment will be given but no details appear since these have already been shown on the individual invoices. Likewise all allowances which have been made will be indicated. The document will appear in the form shown on page 210. Upon receiving it, the retailer will check it with the entries

SPECIMEN CREDIT NOTE

CREDIT NOTE

30th October, 19. .

Credit by

THE WHOLESALE GROCERY SUPPLIES, LIMITED

17 EASTCHEAP,

LONDON, E.C.3.

Messrs. A. Smallman and Son,
21 *City Road,*
Cardiff.

				£	s.	d.
		By allowance in respect of ½ doz. 2 lb. Jars "Radion" Brand Greengage Jam, broken in transit, invoiced on 26th October, 19. .			11	3

made in his own books of account and, having satisfied himself that it is in order, will send a remittance accordingly. By the use of the Statement the two parties are enabled to discover and rectify any discrepancies in their books periodically so that items are not overlooked for long periods of time. In making payment, a covering letter will usually be sent with the remittance stating which items it is intended to cover. Alternatively, some type of *Cheque Enclosure Form* may be employed giving substantially the same information, though this latter document is more likely to be used by a large firm having numerous payments to make than a small one. In due course a *Receipt* will be received from the supplier in acknowledgment.

SPECIMEN STATEMENT AND RECEIPT

STATEMENT

31st October, 19. .

In account with

THE WHOLESALE GROCERY SUPPLIES, LIMITED

17 Eastcheap,

London, E.C.3.

Messrs. A. Smallman and Son,

21 *City Road,*

Cardiff

			£	s.	d.	£	s.	d.
Oct.	26	To Goods	5	7	–			
,,	30	*Less* Allowance as per Credit Note		11	3	4	15	9

No. B 38765 *6th November*, 19. .

Received for
The Wholesale Grocery Supplies, Limited
17, Eastcheap, London, E.C.3
From
Messrs. A Smallman & Son
the sum of *four* pounds
fifteen shillings and *nine* pence

£4 : 15 : 9

2d.
Stamp
J. R. Jones

Terms: Net cash, 30 days.

Receipts are valid only when upon our Official Form.

Cheques, etc., should be made payable to The Wholesale Grocery Supplies Limited.

COLLECTION OF ACCOUNTS.—It should be the aim of every business to develop in customers the habit of making payments promptly. There are four main reasons for this—

(1) Experience shows that the bulk of the losses incurred from accounts receivable are from those overdue. It is almost invariably the person whose accounts are allowed to run unpaid who fails.

(2) By keeping accounts paid in promptly less capital is required, since unpaid debts are capital tied up and no longer available to the business.

(3) Especially with retail houses, prompt collections increase sales because many customers, if an account has run a length of time, dislike to continue buying from that house until it is paid. Besides, as the retail dealer has no such hold on his customer as the wholesaler, his risk is generally greater by letting an account run than is the case with the wholesale house.

(4) Dispute is less likely to occur over an account if attended to promptly; thus there is less probability of the necessity for stringent means to be employed, which is always undesirable from a business standpoint.

METHOD OF HANDLING COLLECTIONS.—The following is a method of handling the collection of accounts. In the first place a statement of each due account should be made out in duplicate; the original statement is sent to the debtor; the duplicate carbon copy is placed in a follow-up folder file. If it is thought that a certain account should be paid in ten days, the duplicate copy is filed forward this length of time; that is to say, if the account is sent out on the 3rd of the month the duplicate copy is filed in the folder behind the guide for the 13th, on which date the account will automatically present itself.

On the 13th reference is made to see if a reply has been received; if not, a letter may be sent, a copy of which, together with the duplicate account, is filed ahead another ten days or any other desired length of time. If the copies of the letters are kept in bound form, then a note on the duplicate of the account may be made indicating where the copy will be found; on the account will also be indicated the ledger folio, so that reference to the ledger account can easily be made.

A series of form letters is of value in the collection department, but must not be wholly relied on. Generally speaking, however,

consecutive form letters may be prepared and sent to delinquent debtors, thus avoiding the necessity of personally dictating every letter. The pressure brought to bear in these letters should be graded, increasing as the number of letters sent unheeded increases.

In some cases Statements are addressed to the debtor, containing remarks which increase in severity with the number of applications for payment; e.g.—

2nd Application—A/c overdue.

3rd Application—A/c much overdue.

4th and Final Application.

Monthly Instalment Accounts. Instalment accounts are constantly changing and any system planned for handling such accounts should provide for the elimination of all dead matter. This may be done by keeping the accounts on cards; one side of the card may be used for a digest of the original contract, the other side for the account and record of the payments, with a column for the balance.

Paid-up accounts should be kept in one index, delinquents should be kept in another.

At the beginning of the month, or at a certain specified time, all due accounts will be in one file. As payments are made they are entered on the respective cards, which are then placed in the file for paid-up accounts, thus eliminating them from the unpaid accounts. By the end of the month all the payments should have been made, and the cards will then have been transferred to the second file, which will contain the unpaid accounts for the next month. All accounts that are not paid up should be removed and followed up closely until paid.

TEST PAPER

GOODMAN & SONS, LTD.

Importers and Wholesale Provision Merchants

BUTE STREET, CARDIFF

Terms: 2½ per cent for payment within ten days.

PRICE LIST (continued)

All prices are subject to alteration at any moment.

Bacon		*Hams*	
Irish Sides	125/-	Short Cut	98/6
Danish	117/-	Longs	96/6
Canadian Wilts	97/6	Squares	71/-
Cumberlands	95/6	Picnics	68/6

1. The above is part of a page from Messrs. Goodman & Sons' Price List. Assume that you are a retail grocer and order a selection of goods from this part of the price list. Draft the whole of the correspondence and the documents that will pass between you and Messrs. Goodman up to the completion of the transaction.

2. A retailer has before him a number of quotations for the same class of goods from wholesale warehouse men. Point out the various factors he must consider before deciding which to accept.

3. What particulars should be given in an invoice? Compare this document with a statement of account, and give an example of the latter containing at least four items.

4. Explain the purpose of "cash discount" and "trade discount," and the circumstances under which each is given.

A buys from a wholesale merchant goods to the value of £50 less 25 per cent on the following terms as to payment: for cash on receipt of invoice, 5 per cent; monthly account, 2½ per cent; three months' account, net. What amount is due—

(*a*) if cash is paid on receipt of invoice;
(*b*) if payment is made at the end of a month;
(*c*) if he postpones payment until the end of three months?

5. What is a credit note and for what purposes is it used?

6. Make out an invoice in proper form for the following goods sold by Robert Jones & Sons, Ltd., Wholesale Grocers, Kirkgate, Wakefield, to William Smith, Main Street, Doncaster, on 2nd March last—

6 doz. packets Porridge oats @ 16s. 9d. per doz.
3 doz. tins pineapple @ 17s. 3d. per doz.
4 doz. O.K. sauce @ 172s. per gross.
6 doz. A.G. tongues @ 19s. 9d. per doz.

Terms: Trade discount 10 per cent, and 2½ per cent for cash within 10 days.

7. William Smith paid the account referred to in Question 6 on 10th March. Enumerate the various means of remittance which he could employ, and give a copy of the receipt which would be sent to him in acknowledgment.

8. What system would you adopt for the collection of overdue accounts?

CHAPTER XXII

The Departmental Store

The departmental store represents one of the forms which large-scale retailing has assumed in recent years. It is possible for expansion of the retail unit to occur in one of two ways: either the size of the individual store may be enlarged in order to undertake a greater variety of business, or the concern may establish branches in other localities in order to open up new retail markets. This second alternative gives rise to the multiple shop systems which are discussed in the following chapter and we shall here concern ourselves with the first type. Now it is a well-known principle of economics that the expansion of an enterprise is limited by the *extent of the market*, and this principle applies in the sphere of distribution as well as in production. If a retail business grows by the expansion of its premises in one location, there is a limit to its turnover of any given class of goods, and this limit will depend upon the number of retail customers which it can attract. Advertising coupled with modern transport developments has enlarged considerably the sphere of influence of such a retail organisation, but if it adheres to its original line of business in the majority of cases its turnover will be definitely limited. In order to escape from this dilemma the proprietors may elect to diversify the business and to stock other classes of goods so that the same customers may be induced to spend a larger proportion of their incomes within the establishment. Thus the departmental store comes into existence. It is usually found in a central shopping district, and a number of such stores may be grouped together. Their prices, quality of goods and services must be competitive.

In England, departmental stores and bazaars first came into existence between the "forties" and "sixties" of the nineteenth century, and some of the early undertakings, such as Whiteley's and Peter Robinson's, still exist. The greatest development of these stores has been in France, however, where the idea was first conceived, the chief examples being the "Bon Marché" and the "Louvre" in Paris. The majority of departmental stores appear to have come into existence as the result of expansion; there are very few examples

of a store being started as the result of a definitely conceived plan. In a very large number of cases, too, the departmental store has its origins in a drapery establishment. This type of business appears to lend itself to the introduction of allied departments in order to attract further custom. In this connection, too, it may be noted that even to-day the departmental store makes its greatest appeal to women.

CAUSES OF DEVELOPMENT.—As we have already indicated, one of the essentials for the development of the departmental store is the presence of a large retail market, so that the growth in the size of the towns in the latter half of the nineteenth century contributed to their development. In order that the shop may gain the full benefit of such a market, it must be situated so as to be readily accessible—in other words, it must be located in a recognized shopping centre. The development of transport facilitated by road and rail in the last few years have tended to strengthen its position in this respect, by widening its market and making it easier for customers to do their shopping. In the same connection, too, the development of the motor vehicle has improved the service of the store to its customers by making speedy delivery an easy matter. Again, although the chief success of the departmental store has been achieved in respect of "shopping" lines, i.e. goods which the consumer purchases only occasionally and wishes to make comparisons before choosing, in recent years considerable extensions have been made in "convenience" lines as well, i.e. goods which are continually required for domestic purposes. The fact that such goods can be ordered by telephone and delivered almost immediately by van has assisted the departmental store immensely in this line of business. From this it must not be inferred, however, that the departmental store is likely to supersede the small shop-keeper. The incomes and buying habits of a large section of the population would prevent such an occurrence.

Finally, the extension of press advertising has further consolidated the position of the departmental store by enabling it to reach and influence the minds of a great number of potential customers. The resources of the store are considerably greater than those of the average independent shop, and in consequence it is in a strong position to undertake this expenditure. Moreover, most of the large departmental stores have developed a mail-order department in order to attract the custom of those whom distance prevents from

shopping in person. Many of the stores have an extensive mailing list of customers whom they circularise periodically with price lists and catalogues. All this publicity strengthens the hold of the store on the retail market and assists in its expansion.

ORGANISATION OF THE DEPARTMENTAL STORE.—The precise details of the organisation of a departmental store vary with the size and the type of business concerned, but the following details afford an indication of the system usually employed. From the standpoint of its legal constitution, the departmental store is usually a limited company so that the ultimate control of policy is vested in the Board of Directors. The actual operations of the business, however, are supervised by a Managing Director, who will be concerned with the general co-ordination of all the activities carried on. The detailed control of the specialised activities of the business will be delegated by him to a series of sectional managers, the customary divisions being Merchandising (including Purchasing and Selling), Staff Management, Maintenance and Service, Advertising, and Accounting and Finance.

(1) **Merchandising.** This section which is the actual profit-earning department of the business is under the control of the Merchandise Manager, and comprises the associated activities of buying and selling. The section is divided into a number of selling departments; at the head of each is a buyer, but where the departments are small, one buyer may control a group of associated departments. Although the general buying and selling policies of the store will be controlled by the Merchandise Manager, the success or failure of a particular department depends largely upon the buyer. In planning the buying for the store it is necessary to make a detailed study of the area served and the nature of the competition to which the concern is exposed. In drawing up a buying programme the buyer can be assisted greatly by statistical records of departmental turnover in former seasons, but in addition a buyer must exercise a kind of instinctive judgment, based on experience and close study of his market as to which lines are most likely to find favour. In this respect he may be assisted by a system of "Want Slips" or "Lost Order Slips" which record inquiries for merchandise which was not in stock.

The difficulties of departmental store merchandising are intensified by reason of the large part which style plays in the selection of

goods. On account of the wide variety of colours and styles, and because of the rapid changes, seasonal and otherwise, it becomes necessary to keep stock down to a minimum. At the same time it is necessary to buy on such a scale as will enable all customers' orders to be executed, for an under-estimate of requirements often cannot be rectified by re-ordering. Manufacturers or wholesalers may have no stocks left on hand. At the same time the buyer must not "over-buy" any particular line since this will entail his having unsold stocks left on his hands which can be sold only after a heavy "mark down," which eats into the profits of his department. Departmental store merchandising is, therefore, a highly skilled business, requiring close contact with the selling side—a fact which explains why the buyer is responsible for his particular selling department.

(2) **Staff Management.** The size of the staff engaged in a large departmental store warrants the creation of a special department under a Staff Manager to deal with the problems of personnel. A number of substantial advantages are to be gained by the introduction of such a department. In the first place the work of staff supervision and selection is concentrated in one office so that a uniform policy may be put into operation in respect of it. Departmental managers are sufficiently occupied in the supervision of their own departments and can have no time to spare for the routine work of staff recruiting. Again, such a department can make effective use of the available labour force by providing for the transfer of staffs from one section to another in exceptionally busy times, whilst the employment of temporary assistants can be placed on a proper basis. Such a department also acts as a safeguard to see that the general policy of the business is observed with regard to the size of the staff, the scales of wages paid and general working conditions.

A very important part of the work of the Staff Department is connected with training and recruitment. It will be the aim of the department to provide a supply of suitable recruits for vacancies on the selling staff. For this purpose a record of all desirable applicants should be made so that they may be called up at any time in the future if a vacancy occurs for which they are fitted. When suitable persons have been selected in this way they cannot be left to their own devices to "pick up the business," especially in the

case of young people. They must receive a systematic course of training, partly in the business itself and partly in outside educational institutions. Thus, in every business, there are certain matters of internal organisation and routine which are peculiar to that concern and the newcomer must be acquainted with them. In addition, however, if he is to discharge his duties efficiently he will require knowledge of another type—of the commodities he is handling, of business organisation and routine, commercial mathematics, and so on. This may be gained by attendance at outside classes. In either case, the Staff Department will supervise the matter and record the progress which is made and such considerations are bound to play a part when the question of promotion is raised.

(8) **Maintenance and Service.** Under this heading we have the section of the business which is concerned with the maintenance of the store properties and of all the services rendered to the customers. In a large business the upkeep of the premises is a task of some magnitude. The repairs and alterations are continually taking place, whilst fixtures, fittings and equipment have to be constantly inspected to see that they are kept in proper condition. Again, such items of equipment as lifts, fire-fighting appliances, electrical equipment, and ventilating plant depend for their efficiency upon regular inspection, and neglect may endanger not merely property, but human life. A large business will, therefore, employ a skeleton staff of artisans to look after these matters, and this staff will be supplemented from outside when larger repairs or alterations have to be undertaken.

In this section also we have the organisation for the packing and delivery of goods to customers, which often assumes considerable dimensions. One of the features of departmental store service to customers is that of the free delivery of goods, and this delivery may be made either in the firm's own vehicles or by an outside carrier. At the present day most large firms maintain their own fleets of motor vehicles for short range deliveries, and rely upon outside transport services only for work which cannot be performed economically by themselves. Delivery in a firm's own vehicles possesses a certain advertising value to the business whilst, if properly organised, it can confer the advantages of greater convenience and safety. Parcels which have to be entrusted to an outside carrier must be strongly packed to avoid any possibility of

damage, but when they are delivered by the firm's own servants, such elaborate packing is not necessary. The delivery organisation must make arrangements for the collection of goods from the showrooms and see that the dispatch instructions issued by the salesmen are duly carried into effect. The manager in charge of the section must schedule his deliveries in such a way that the vehicles under his control are used in the most economic manner, and at the same time he must maintain a proper standard of service.

(4) **Advertising.** The departmental store has always made an extensive use of advertising for the purpose of attracting customers, and developments of recent years have tended to extend these activities. The advertising section must work in close collaboration with the merchandising departments, whilst at the same time there must be co-ordination between all the forms of publicity employed. A certain appropriation will be allocated to the department each financial year, and this must be distributed over the various advertising media so as to secure the best results. Extensive use will probably be made of Press advertising, but this will be supplemented by direct mail advertising in the form of catalogues and price lists. Advertising by means of car bills and posters will also be employed to a varying extent, particularly at sale time, or at special seasons, such as Christmas and Easter.

In close association with the advertising activity is the display section which attends to window and shop display generally. This work has assumed special importance of recent years and has become a specialised occupation in a big business. It must be remembered that although advertising may draw customers to the shop, it will not always induce them to come inside and make purchases. If, however, Press or other advertising is supported by an effective display of the actual goods, sales may be made. The aim of the display section will be to create the right "atmosphere" at different periods according to the season, and give prominence to selected types of merchandise.

(5) **Accounting and Finance.** In view of the complexity of the operations and the large capital involved, the control of the finances of the undertaking is a very important matter. The first requisite is to have an effective system of cash control, the object being to provide that all cash received shall pass into the hands of the cashiers as quickly as possible and be recorded at once. Under

EXPENSE BUDGET FOR THE SIX MONTHS ENDING 31st JULY, 19..

Classification	Complete Period (28 Weeks)				February (4 Weeks)				March (5 Weeks)			
	Estimated	Actual	Estimated	Actual	Estimated	Actual	Estimated	Actual	Estimated	Actual	Estimated	Actual
	£	£	%	%	£	£	%	%	£	£	%	%
Net Sales	300,000				40,000	38,900			55,000			
Gross Margin	90,000		30·0		12,000	11,670	30·0	30·0	16,500		30·0	
I. Administrative Expenses												
Executive Salaries	4,500		1·5		750	750	1·88	1·93	750		1·36	
Bad Debts	600		·2		100	100	·25	·25	100		·18	
Audit and Accountancy	3,000		1·0		450	475	1·12	1·22	580		1·05	
Stationery, Postage and Telephones	1,200		·4		175	197	·44	·51	225		·41	
Insurance	300		·1		50	50	·12	·13	50		·09	
Legal and Professional Service	1,300		·1		50	27	·12	·07	50		·09	
Clerical and General Wages	1,500		·5		240	265	·60	·68	300		·55	
Miscellaneous	2,100		·7		330	240	·82	·61	350		·64	
	13,500		4·5		2,145	2,104	5·35	5·41	2,405		4·37	
II. Occupancy												
Rent	6,000		2·0		900	900	2·24	2·34	1,160		2·11	
Rates	3,000		1·0		450	450	1·12	1·17	580		1·05	
Heat, Light, Power and Water	3,000		1·0		450	450	1·12	1·17	580		1·05	
Maintenance and Repairs	1,500		·5		240	250	·60	·65	300		·55	
Depreciation	1,500		·5		240	240	·60	·61	300		·55	
Cleaning	1,500		·5		240	240	·60	·61	300		·55	
	16,500		5·5		2,520	2,530	6·28	6·55	3,220		5·86	
III Publicity												
Advertising	10,500		3·5		1,590	1,600	3·96	4·16	2,000		3·64	
Display	1,500		·5		240	250	·60	·65	300		·55	
	12,000		4·0		1,830	1,850	4·56	4·81	2,300		4·19	
IV. Merchandising												
Buyers	5,400		1·8		810	820	2·01	2·13	1,010		1·83	
Receiving and Marking	600		·2		90	90	·22	·23	110		·20	
Selling Staff	18,000		6·0		2,700	2,690	6·72	7·00	3,480		6·33	
	24,000		8·0		3,600	3,600	8·95	9·36	4,600		8·36	
V. Dispatch												
Packing and Wrapping Materials	600		·2		90	90	·22	·23	110		·20	
Delivery Charges	3,900		1·3		585	580	1·45	1·48	730		1·33	
Dispatch Room and Packers	1,500		·5		240	240	·60	·61	300		·55	
	6,000		2·0		915	910	2·27	2·32	1,140		2·08	

Note. This statement will be continued to show the details for each month.

most systems of cash control, each salesman makes a summary of his sales which can be compared with the summary submitted by each departmental cashier. In certain cases, where it is not desired that the sales people shall handle cash, customers are requested to pay at conveniently situated cash desks or their money is taken at the sales counter and then sent by pneumatic tube to a central cash office. In the case of credit sales a check must be made with the Credit Sanction Office to ensure that the customer's account is in order and permits of a further credit.

The Accounting Section will also be in charge of the ledger accounts, and, since the average departmental store does an extensive business on a credit basis, the amount of work entailed is usually considerable. Most of the large departmental stores have adopted mechanical methods in their book-keeping section in order to cope with the volume of work. This is also rendered necessary by the elaborate analysis of the figures of sales, expenses, and so on, which is required for the purposes of effective financial control. In this connection the large departmental stores have, in recent years, made an increasing use of systems of *Budgetary Control*, i.e. a deliberate planning of expenses in relation to turnover during a trading period, instead of relying merely upon the financial accounts which give information which is retrospective in character. The starting point is the construction of a merchandise budget which must be drawn up for three or six months in advance, estimating the probable monthly sales and gross margins.

The budget so framed must be elastic, and each succeeding month's estimates will probably require amendment in the light of experience. Thus, an over-spending of advertising allocation would probably mean a reduction in future months. Each month's results must be carefully compared with estimates if full value is to be extracted from the system. The table on page 220 gives a specimen of a typical budget, the actual results for each month and for the half-year being inserted in the columns provided for comparison.

LIMITATIONS OF THE DEPARTMENTAL STORE. In all parts of the world the departmental store is now being subjected to pressure by other forms of retail organisations which have developed during the last few years. Among its defects may be mentioned the following—

(1) Over-development, for competitive reasons, of expensive customer-services and excessive advertising costs.

(2) Too many departments and merchandising units, combined with too wide a range of merchandise.

(3) Low productivity in comparison with newer types of distribution, reflected in low volume of business per employee or per square foot of space.

The very variety of merchandise which has to be stocked is often a source of potential weakness, especially during a period of falling prices. Although the leading stores have taken active steps in the last few years to reduce unnecessary price ranges and variations in quality and style, the ordinary multiple shop, which concentrates its attention on a narrower field, has a much easier merchandising problem to solve. Further, the departmental store is no longer the only retail organisation which enjoys the advantages of large-scale buying, and while the individual department may still retain its supremacy in that direction over the ordinary retail shop, it can no longer hope to compete in mere purchasing power alone with the large multiple organisations.

TEST PAPER

1. When and why did *Departmental* Stores first come into existence?
2. Show how responsibility is delegated in the case of a Departmental Store.
3. Describe any large Departmental Store with which you are acquainted, and point out the chief features of its organisation.
4. A retail trader gives you the following information concerning his three principal departments—

Average Stock at Cost Price	Annual Turnover	Percentage Mark-up on Cost Price (to Determine Retail Selling Price)
Department A, £500	8	$33\frac{1}{3}$
,, B, £1,500	$4\frac{1}{2}$	50
,, C, £480	$2\frac{1}{2}$	60

Find (*a*) his gross profit for the year, (*b*) his average annual turnover. (*R.S.A.*)

5. The cost of doing business (measured as a percentage of turnover) is greater in the case of large departmental stores than in the case of small specialised shops. Why should this be so, and what bearing has this on the future development in retail trade?
6. What are the conditions which would appear to be essential to the success of departmental stores? Describe a suitable form of organisation for a departmental store with four selling departments.

7. The following is an extract from the statistical report of a large retail departmental store—

Average Stock at Cost	Annual Stock Turn	Margin of Gross Profit	Expenses
Furniture Dept., £1,500	3	30	25
Ironmongery „ £1,000	5	25	20
Grocery „ £2,000	10	20	16

(Margin of gross profit and expenses are percentage of turnover.)

Find the total gross and net profits earned by the three departments. Find also the average cost of conducting the business.

CHAPTER XXIII

The Multiple Shop System

GENERAL CHARACTERISTICS.—A multiple shop or "chain store" system may be defined as a system of branch shops operated under a centralised management and dealing in a limited line of goods. (As has already been pointed out, there are now in existence a number of "Multiple Departmental" Stores—those which have many branches and sell many lines of goods in each branch.) Apart from this general characteristic the details of the organisation and management of individual businesses vary widely. As already indicated in the general survey of retailing organisations, the multiple shop system is the natural product of business expansion when extension requires the multiplication of selling points rather than the expansion of existing premises. For this reason we can find all over the country embryo multiple shop systems, a few of which may ultimately expand into regional or even national chains, though the great majority are likely to expand to a certain point and then stop. The reason for this is not far to seek. In the case of most businesses which are developing, there arrives a critical period when, if further expansion is to take place, a drastic re-orientation of method becomes necessary. Furthermore, even if that re-organisation were to be effected, it by no means follows that the man who can efficiently manage half a dozen shops will possess the capacities needed for running twenty. In consequence, therefore, expansions of this type tend to go so far and then stop, and the typical problems associated with chain store organisation and management do not arise.

The urge towards the formation of trading systems of this type is not confined merely to the retail end of the distributive system, for we also have a number of multiple shop systems which have been created by manufacturers. In many lines of industry manufacturers have explored the possibilities of producing goods cheaply on mass production lines, but have failed to find a satisfactory market through existing trade channels. In order to provide an outlet for their goods they have set themselves to gain control of a system of retail shops, either by opening new shops in selected neighbourhoods, or by securing the control over shops already in

existence. A similar policy may have been pursued with a view to diverting to themselves the middleman's profit, but this aspect of the matter will be discussed in a later chapter. Now, inasmuch as such a policy would involve the manufacturer in a close consideration of retail problems he will stand a greater chance of success if he can limit the number of his retail outlets consistent with obtaining that efficiency of distribution which he is seeking. He will, therefore, stand a good chance of success if he is dealing in what are sometimes described as "shopping lines," i.e. consumers' goods of a relatively durable type which are purchased at infrequent intervals usually at a recognised shopping centre, such as boots and shoes, or clothing. Again, if the article being sold is such as to require that expert advice and assistance shall be given to the consumer when making the purchase, it may prove more satisfactory to the manufacturer if sales take place through his own shops where assistants can receive the requisite degree of training to give this service. Furthermore, by developing a multiple shop system of distribution, a manufacturer may consolidate his hold upon a particular market and make it difficult for competitors to obtain a footing. If distribution is made through independent retailers, these may be won over by a new competitor, but where distribution is through the manufacturer's own shops this difficulty does not arise. Unless some of these considerations apply this method of distribution may prove unsatisfactory to the manufacturer.

CLASSES OF GOODS.—A further question arises as to the types of products which are most suitably handled by a multiple shop system. In this connection it is impossible to be dogmatic, for this system of distribution has been applied to one set of products after another in recent years with the result that it would almost appear that, given the right management and methods, almost any type of product can be handled. None the less it is possible to lay down certain wide considerations which influence the suitability of a product for this class of business.

(1) The articles should be of such a type that a *rapid turnover* may be expected. The expenses of multiple shop operation are considerable, both on account of the centralisation of management and control, and also because of the high rents which are paid by branches in order to secure the most suitable sites. Hence, these overhead charges must be spread over a big turnover in order to keep selling

prices down to a minimum. The need for a large turnover is intensified by the fact that in many cases the multiple shops appeal to their clients on the score of cheapness and, therefore, fix their selling prices at a lower level than their competitors.

(2) In order to achieve the first objective, the commodities handled should be *necessities* or semi-necessities which are in constant demand. Thus, foodstuffs, articles of clothing and footwear are commonly dealt in by the multiple shops, though perishable foodstuffs are not frequently handled by this system of distribution, probably owing to the difficulties of applying a centralised system of purchasing and stock control to them. The multiples have a further inducement to deal in necessities in the fact that the demand for such commodities is relatively steady and may therefore be more readily predicted. The consumer demand for fashion goods is essentially capricious, so that a multiple shop system which handled such goods would be exposed to very serious risks for which the possibility of large profits would be no adequate compensation.

(3) Generally speaking, the article should be of the standardised *branded type* requiring little selling effort on the part of assistants. In spite of what has been said above with regard to the establishment of multiple shop systems by manufacturers for the purpose of providing specialised selling services, a large part of multiple shop selling is of a routine character, where the function of the assistant is mainly to pack the goods and take the cash from the customer.

(4) The territory served by the branches should be one in which the units are not too far apart to permit of *effective supervision and supply* from centrally located warehouses. Since centralised buying is one of the advantages enjoyed by multiples, individual branches should not be separated by great distances, otherwise this advantage will be lost by heavy costs of carriage. In the case of national multiple shop systems the same rule applies, but the organisation may be divided on a district basis for administrative purposes.

(5) In view of the fact that multiple shops usually aim at reducing auxiliary selling services to a minimum, the articles sold should be of a *portable type* which are usually purchased in small amounts so that customers may easily carry them away. In this way the cost of free delivery services is saved.

PRINCIPLES OF MULTIPLE SHOP OPERATION.—The multiple shop system is faced with the difficult problem of reconciling two

principles—the *centralisation* of buying and administration with the *decentralisation* of selling through a large number of branches. In the first place, it will have to be decided how far this centralisation of administration is to be carried; in other words, how much power is it advisable to delegate to branch managers. A branch manager may have so little discretion allowed to him that he sinks to the level of a senior shop assistant, with the result that the whole system is liable to become bureaucratic and lose in efficiency through inelasticity. On the other hand, if branch managers are given too much latitude, the organisation may get beyond proper control. The secret of successful organisation will be to strike the happy medium and, in any case, clearly to define the limits of authority delegated to the local management.

Again, the multiple shop system operates on the principle of making centralised purchases, pooling the requirements of the whole system, and buying in bulk. In the case of standardised branded goods which are in widespread demand, this policy is sound, but in any line of business where there is scope for the action of local prejudices it may be opened to criticism. In the case of certain types of goods which may be stocked by branches it may, therefore, be expedient to adopt some measure of decentralisation and allow managers discretion, within limits, as to the goods which they will stock.

The decentralised selling activities of the multiple shop system call for special organisation in such matters as cash and stock control. Unless a careful and systematic check is kept over branches in respect of these matters an avenue to heavy losses is opened up. Special arrangements have to be made for invoicing goods to branches, a common arrangement being to invoice them at the retail selling price since this facilitates stock control. The branch manager then has to account for a certain value of goods sent to him, and the amount of his sales together with the value of his stocks at any time should correspond with the value of goods invoiced. Cash takings have usually to be paid into the local bank to the credit of Head Office Account at frequent intervals, and a return made either day by day or at the end of each week.

The success which has attended multiple shop operation has been largely due to the close attention which the majority of these organisations have paid to certain aspects of retail business practice

which are often neglected by the small independent retailer. To these we shall now turn our attention—

(1) **Accounting.** One of the factors in favour of the multiple shop system is the close attention which is paid to accounting and statistical records. It was pointed out by the Linlithgow Committee on the Distribution and Prices of Agricultural Produce that very few small traders keep accounts in such a way as to show the relationship of the constituent elements in the costs of their respective undertakings. Now a trader who fails to keep proper accounts can exercise no adequate control over the various items of cost which are incurred in the course of his operations. He cannot compare his expenses now with those of previous periods, nor can he compare his experience with that of businesses of a similar type. The multiple shop system, in its very nature, cannot afford to allow any items of expenditure to pass beyond effective supervision, and has consequently devoted considerable effort to the development of a technique of statistical and accounting control which is capable of shedding light on all the manifold activities of the business. Undue increases in expenditure are immediately revealed and eliminated, whilst the experience of one branch can be compared with that of another, and a close check kept upon the efficiency of every unit in the organisation.

(2) **Advertising.** The second advantage which the multiple shop system enjoys is the attention which it can devote to problems of advertising. It can afford to employ specialists either on its own staff or through recognised advertising agencies—a course of action which is quite beyond the means of the small independent retailer.

(3) **Purchasing.** The requirements of a multiple shop system for merchandise are larger than those of many wholesale firms, so that it is possible for such an organisation to go back to the original sources of supply and purchase its requirements on the best possible terms, in view of the quantity and regularity of the flow of orders. They may take the bulk or the whole of the output of several manufacturers and so be in a strong position as "monopoly consumers." Indeed this situation has led many multiple stores to set up their own factories to produce the goods they sell and so bring about a vertical integration of manufacturing, wholesaling and retailing functions.

(4) **Business Location.** The location of a business enterprise,

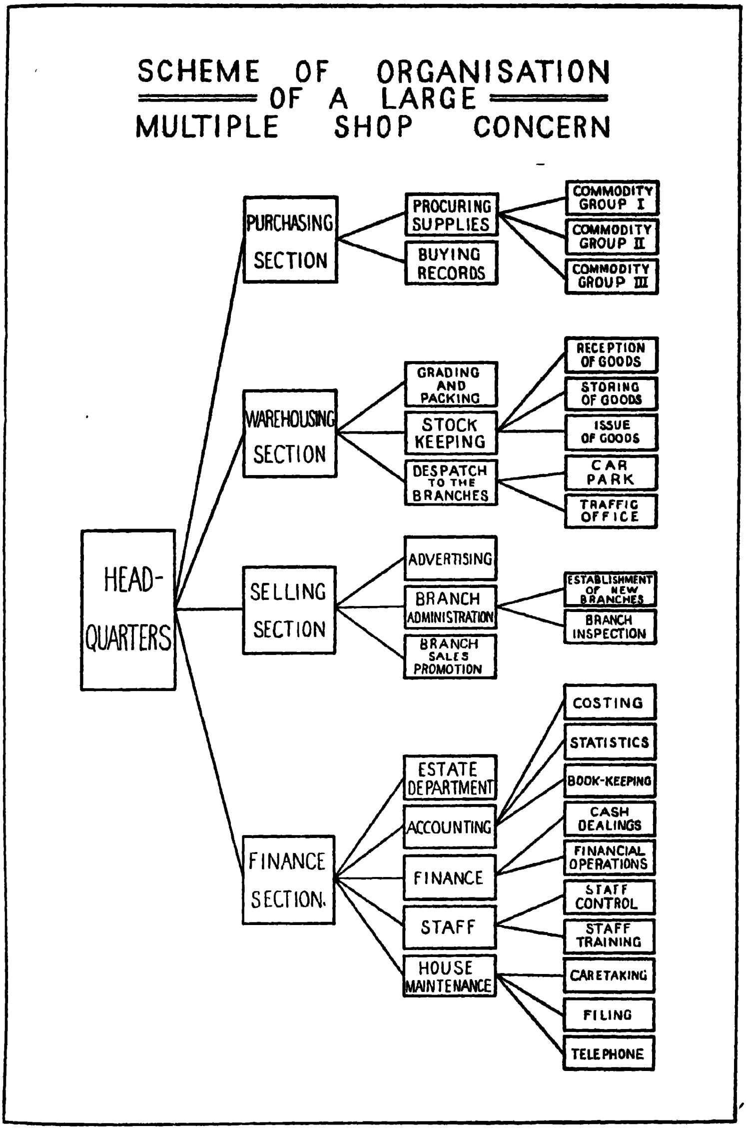
particularly in the retail trade, is one of the most important determinants of success. In this respect the small retailer is at a disadvantage, because even in those infrequent cases where he has the ability to judge the merits of a site, he rarely possesses the capital to enable him to acquire it. The multiple shop company, on the other hand, will usually have a special estate department which can not only investigate sites for opening new branches, but also watch developments in connection with existing branches. Indeed, the movement of shopping centres is a factor of immense importance to the retail trade. The development of housing schemes creates new centres of population, whilst the decline of certain industrial centres destroys what were once good retailing centres. These developments can be followed closely by the multiple shop companies, and, on account of their capital resources, these concerns can take advantage of the information which they collect.

(5) **Specialisation.** The principle of specialisation may be said to be applied in two ways in a multiple shop system, viz. in regard to the merchandise and in respect of the staff. In the first place, the majority of multiple shop companies specialise in handling a limited number of lines, e.g. meat, dairy produce, or groceries, thereby leading to a simplification of retailing methods and equipment. Secondly, on account of the large scale of the operations and the attempts made at centralisation of business control, scope is offered for the specialisation of personnel. Thus, opportunity arises for the employment of expert buying agents to purchase merchandise for the whole organisation; accounting and statistical records can be compiled under the supervision of experienced accountants, whilst the management of the business premises devolves upon the estate manager. On the side of publicity, experienced advertising experts may be employed, whilst specialist advice can be given to individual branch managers on such matters as window display and the arrangement of stock. In a smaller concern, these matters have usually to be dealt with by one man who, no matter how great his ability may be, cannot hope to deal efficiently with them all.

ORGANISATION OF A MULTIPLE SHOP BUSINESS.—The multiple shop business is an attempt to reconcile a centralisation of administration with decentralised selling, and many of the special problems of such a system arise on this account. The central administration of the whole enterprise will be found at the head office, where, in

a large organisation at all events, four sections may be recognised —Purchasing, Warehousing, Selling, and Finance. The *Purchasing Department* is, of course, a very important section of head office organisation, since the policy of the multiple shop is to pool the requirements of its branches and to buy in bulk. The demands made upon the concern often necessitate going out into the world's markets and purchasing in large quantities as well as in advance of actual requirements. In order to supply branches with the newest styles and latest discoveries it is essential that all sources of information be tapped. The fact that a large proportion of the capital of a multiple shop company is invested in stock constitutes its greatest weakness or strength according to the measure of skill exercised in the buying. The exact organisation and policy of this department will depend partly upon the size of the business, and partly upon the type and range of articles which are regularly stocked by the branches. Moreover, further modification will take place if the business manufactures some or all of its requirements in its own works. When purchases are made goods will be sent direct to the branches whenever this is possible, but usually it will prove necessary to maintain warehouses for holding reserve stocks and in order to make bulk purchasing possible. The *Warehouse* may be situated on the same premises as the head office, or a policy of decentralisation may be followed by locating branch warehouses in the areas which they are expected to serve. Again, different warehouses may be employed for different classes of goods where special conditions of storage are called for.

A number of different systems of supplying branches with stocks are employed, but generally speaking responsibility for maintaining stocks may rest either with the head office or with the branch managers. From the standpoint of effective control the former system is probably the more efficient. The branch managers make weekly returns of stock movements, and upon the basis of these returns the Branch Supplies Department at head office can determine the requirements of each branch, and instruct the warehouse to make such deliveries as are considered necessary. In this way overstocking as a result of mistakes of the branch management is avoided, and a uniform policy can be followed in respect of all branches. For the purpose of the delivery of goods from warehouse to branches, the multiple shop may maintain its own transport department.


SCHEME OF ORGANISATION OF A LARGE MULTIPLE SHOP CONCERN
HEAD-QUARTERS
PURCHASING SECTION
PROCURING SUPPLIES
BUYING RECORDS
COMMODITY GROUP I
COMMODITY GROUP II
COMMODITY GROUP III
WAREHOUSING SECTION
GRADING AND PACKING
STOCK KEEPING
DESPATCH TO THE BRANCHES
RECEPTION OF GOODS
STORING OF GOODS
ISSUE OF GOODS
CAR PARK
TRAFFIC OFFICE
SELLING SECTION
ADVERTISING
BRANCH ADMINISTRATION
BRANCH SALES PROMOTION
ESTABLISHMENT OF NEW BRANCHES
BRANCH INSPECTION
FINANCE SECTION.
ESTATE DEPARTMENT
ACCOUNTING
FINANCE
STAFF
HOUSE MAINTENANCE
COSTING
STATISTICS
BOOK-KEEPING
CASH DEALINGS
FINANCIAL OPERATIONS
STAFF CONTROL
STAFF TRAINING
CARETAKING
FILING
TELEPHONE

In many of its aspects the *Finance Section* of the head office will not differ from that of other large business. If, as is usually the case, the business is organised as a joint stock company, there will be a Secretary's Department dealing with the routine matters of company work. The Accounting Section deals with the financial records, although in this case comprehensive statistical records will be necessary for the purpose of comparing the results of one branch with those of another. This department will also deal with the various returns which have to be made by the managers of each branch. The most important of these is the *Weekly Stock Report*, which gives details of—

(*a*) Opening stock of each line of goods.
(*b*) Deliveries received during the week.
(*c*) Balance on hand at the end of the week.
(*d*) Sales for the week, i.e. (*a*) + (*b*) - (*c*).

In addition to this return, which is concerned mainly with quantities, a *Weekly Cash Return* must also be submitted. This return can be simplified considerably if cash sales only are made, but if credit transactions are allowed full details must be furnished to the head office.

On the sales side of the multiple shop business, a staff of specialists will be maintained at head office for the purpose of organising the control of the branches and for keeping the management in touch with local conditions. General advertising, window display, and similar matters will be directed from head office so that a co-ordinated policy is initiated for the whole organisation. The head office is brought into touch with the branches through the medium of a District Manager or Inspector who is responsible for the conduct of the branches in his area. These officials have to check the stocks of the branches and make an independent verification of other details in the returns supplied to head office in the course of their periodical visits. The greater the degree of independence allowed to the branches, the more important and onerous do these duties become.

TIED SHOP.—A form of retail trade closely allied to the multiple-shop type is carried on in undertakings acting as agencies, and often "tied" to some large firm. The most common example of this kind is the "tied" house in the licensed victuallers' trade, where a brewery controls a chain of public-houses devoted solely to the sale

of its products. In a certain measure the same custom prevails in the tobacco and jewellery business. In the latter trade the stock is all supplied on credit, and though ostensibly the business is independent, in reality such independence is entirely fictitious; the jeweller is simply a salesman on commission and the business may be described as a "tied shop."

TEST PAPER

1. What is meant by the Multiple Shop System?

2. Contrast and compare the Multiple Shop System and the Departmental Store.

3. "The Multiple Shop System is an attempt to eliminate the profits of the middleman." Explain this statement.

4. In the case of the Multiple Shop System, is it always advisable to supply the shops from *one* central depot? If not, why not?

5. Enumerate some of the chief advantages of distributing goods through a system of Multiple Shops.

6. What are the chief advantages possessed by a retail shop conducted by its owner over a retail shop forming one of a group of multiple shops? Under what circumstances is the latter the more successful form of business?

7. "A proportional application of the principles of centralisation and decentralisation is the secret of successful organisation in a system of multiple shops." Expand this statement and discuss its significance.

8. A limited company carrying on business as gentlemen's outfitters has a factory and central warehouse and a number of retail establishments situated in different towns. The head office supplies the branches with all goods. Your advice is sought as to the best method to be adopted for the purpose of charging out goods supplied to the branches, and allocating between them the following items of expenditure—

Advertising manager's salary.
Cost of advertising.
Service of motor vans.

Give your answer in the form of a report to the directors.

9. Mr. T. Jones is South Wales District sales manager for Robinson & Brown, Ltd., Wholesale Clothing Manufacturers, 54 Oxford Street, Manchester. Draft a copy of his report to Head Office for the week ended 30th June last, embodying the following points and any others which suggest themselves to you—

(*a*) Retail business is quiet following the sales rush at Whitsun, but is expected to improve during July.
(*b*) Retailers inquiring for quantities of low priced goods for July "sales."
(*c*) Serious complaint from one firm regarding delayed deliveries.

10. What is meant by a "tied shop"? Give an example.

CHAPTER XXIV

Distributive Co-operation

A co-operative distributive society is a combination of persons whose aim is to economise by buying in common and to retain their profits by selling in common. These societies were, to a great extent, a consequence of the Industrial Revolution, which led to the creation of a large permanent working-class, who organised themselves as wage-spenders in the co-operative stores. The movement has flourished chiefly in Lancashire, Yorkshire, the Midlands, and in the Valley of the Clyde; in short, in those districts where trade unionism has been most successful. It has also now developed quite extensively in London and the Southern Counties.

Characteristics of a Co-operative Society.—The distributive societies of the present day are based on the plan of the famous Rochdale Equitable Pioneers' Society, founded in 1844. The founders of this Society, recognising that every producer is also a consumer, aimed at providing for the needs of their members in both of these capacities. The first object of the Pioneers was "the establishment of a store for the sale of provisions, clothing, etc.," but ultimately they considered that "this society shall proceed to arrange the powers of production, distribution, education, and government; or, in other words, to establish a self-supporting home colony of united interests, or to assist other societies in establishing such colonies." Now, one of the great difficulties experienced by the average business engaged in distribution is that of ensuring regularity of demand. From the outset, however, the co-operative stores adopted a device in the form of a dividend upon purchases that ensured such a demand. Under the Rochdale plan, the shareholders got 5 per cent interest on their capital, while the customers got the remainder of the surplus of sale receipts over purchase price plus overhead charges, and what the customers got was treated as a rebate, and was not regarded as a profit made by the vendor society. After a time, however, there was a departure from the rule originally followed, and by setting aside a larger portion of their surpluses than was essential for normal reserve fund purposes, the

societies were able not only to expand their operations on modern competitive lines by opening new shops and purchasing established businesses outright, but also to subscribe to the capital of the wholesale societies.

Co-operative societies are governed by the provisions of the Industrial and Provident Societies Acts, 1893–1954. They possess the following characteristics—

(1) **Open Membership.** Membership is open to all comers, the committee of the society, however, usually having the right to refuse the admission of any person whose membership is regarded as likely to be detrimental to the interest of the society. In this respect the co-operative society differs from the registered company since the membership of the latter is limited by the amount of its nominal capital.

(2) **Democratic Control.** Almost without exception each individual member possesses one vote, irrespective of the number of shares held. Where share capital is owned by other societies, these societies are usually allowed additional votes in some proportion to the amount of share capital held by them. These provisions prevent the domination of societies by groups of large shareholders. In the absence of any disqualifying rule, every person who has been admitted to membership and has had his name added to the list of members is entitled to vote even though his share or shares are not fully paid.

(3) **Provision of Capital.** The shares in a society (which are invariably issued at par value) are in all cases of small amount, usually £1. They may generally be paid up by weekly or quarterly instalments, or by the automatic accumulation of the sums accruing to the holder as his share in the profits of the society without the necessity for any cash payment beyond a trifling amount paid on allotment. A co-operative society can increase the amount of its share capital to any figure it likes, so long as no individual holds a greater amount of shares than £500. The bulk of the share capital is withdrawable at short notice, though many societies compel each member to hold at least one transferable share, which can be realised only by sale.

(4) **Limitation of Interest on Capital.** The return on share capital is in most cases limited to a fixed rate of interest, usually 5 per cent per annum. In some societies the full rate of interest is not paid

if the member's purchases fall below a stated amount in a given period.

(5) Distribution of Surplus. As already indicated, these are usually distributed among the members in proportion to the amount of each member's purchases. In this respect the practice of the societies is in sharp contrast with that of the joint stock company, where the surplus is distributed as a dividend on share capital.

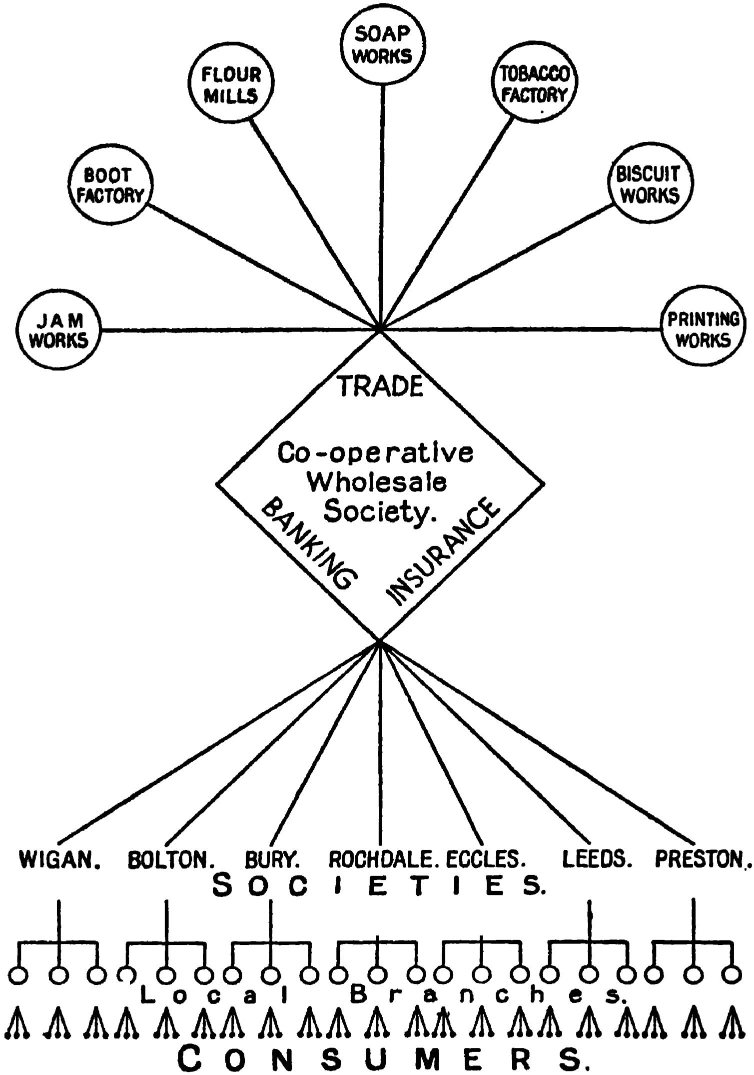
THE CO-OPERATIVE RETAIL SOCIETY.—In accordance with the fundamental assumption in the theory of co-operation that economic organisation should be based upon the supply of consumer's wants, co-operative organisation naturally starts from the consumer. Hence, the foundation of the whole structure of the co-operative movement in this country is the society of purchasing members known as the retail society. It is the members of these retail distributive societies who supply the great bulk of the capital of the movement, and from their number are chosen its administrators and most of its employees. Thus, in 1958 there were 1,015 retail societies with a combined membership of more than twelve millions. The number of members is continually increasing whilst the number of societies has diminished. When new areas are opened up for co-operative distribution, it is now usually possible for an old-established society, operating within a reasonable distance, to cover the area, so that there is no need to form a new society. Again, in recent years there has been a tendency for the size of the typical business unit within the movement to increase. This process is still continuing fairly rapidly through amalgamation of old-established societies, thereby leading to a reduction in their number.

The control, management, and administration of a co-operative society are divided among the members, the committee, and the permanent officials, and in this respect the organisation bears a certain resemblance to that of a joint stock company. As a democratic organisation, the control of the society is vested in the members, but at the present day this control is exercised through a committee, and is limited to the approval or criticism of the actions of this body. The committee itself is responsible for the general administration of the society and should, therefore, keep in close touch with the members, whose wishes on all matters of policy should be consulted. For the purpose of economising time and securing greater efficiency, the committee may divide itself into

sub-committees to supervise and keep in touch with each department and the manager. Each sub-committee will receive regular reports from the management with regard to the activities of the section of the business with which they are concerned, and upon these they can base their decisions and recommendations.

Trading Policy of the Retail Societies. The growth of the co-operative movement has been accompanied by development on the part of its competitors, so that to-day the societies are faced by more intensive competition than at any time in the past. The competitors of the movement, notably the multiple shops and departmental stores, have steadily improved their organisations and their methods of doing business. The multiple shop, for example, as we have already seen is rendered formidable on account of the high degree of specialisation which attends its operations. Multiple shops, selling a limited number of lines of goods, can buy to greater advantage than would be possible were they to stock a wider range. The buyer can watch his markets better and stocks can be kept more easily under control. On the selling side, prices can be varied more promptly to meet changes in market conditions, whilst smaller stocks in relation to turnover are required in the shops so that economies in the use of capital are secured. Furthermore, the competition of these concerns is by no means confined to the large towns, but is found throughout the country in all the lines of goods ordinarily stocked by the co-operative societies.

One of the difficulties of the co-operative retail society arises from the fact that it attempts to run specialised branches in a number of different lines—grocery, butchery, drapery, etc.—and they do not always blend very well. Again, the multiple shop pays a considerable amount of attention to the external appearance of its premises and the display of its goods, whereas the co-operative society, in many cases relying upon the loyalty of its members, has paid insufficient attention to such matters. In regard to managerial control, too, the large-scale competitors of the co-operative stores have set themselves to perfect systems of accounting and statistical control which enable them to keep in the closest touch with every aspect of business operation. Many societies are backward in this respect and are, therefore, handicapped from the standpoint of competitive efficiency. From the standpoint of control, the government of the societies through committees imposes


SOAP WORKS
FLOUR MILLS
TOBACCO FACTORY
BOOT FACTORY
BISCUIT WORKS
JAM WORKS
PRINTING WORKS
TRADE
Co-operative Wholesale Society.
BANKING
INSURANCE
WIGAN. BOLTON. BURY. ROCHDALE. ECCLES. LEEDS. PRESTON.
SOCIETIES.
Local Branches.
CONSUMERS.

certain disadvantages, usually on account of the fact that committees often take upon themselves duties and responsibilities which they ought to leave to managers and officials. This practice not only delays decisions, but stifles initiative and weakens the sense of responsibility in the officials.

THE CO-OPERATIVE WHOLESALE SOCIETY.—The Co-operative Wholesale Society is a federation of societies, the purpose of which is to control for the benefit of all co-operators those stages of manufacture, importation, merchanting, and financing through which most goods pass before they reach the retail store. The society was first registered in 1863 with the object of doing a certain amount of wholesale buying on behalf of the various new co-operative stores of the northern counties. The early years of its life were full of doubts as to its strength and capacity to live, but it is to-day, with the exception of Centrosoyus, the largest co-operative society in the world. The functions of the Co-operative Wholesale Society can be divided into four parts, namely—

(1) **Wholesaling.** The factoring of goods is probably the most important of the various activities of the society, and accounts for the largest part of its trade. The large variety of goods which the co-operative societies supply to their members has resulted in the Co-operative Wholesale Society having numerous sales departments, from which the buyers of the retail societies can obtain the goods they require. These sales departments are established at three main centres, Manchester, London, and Newcastle; and on a somewhat smaller scale at Bristol, Cardiff, Northampton, Plymouth, Birmingham, Nottingham, Liverpool, and Leeds. Each serves a definite area, and the managers or buyers of the retail societies regularly visit the salerooms at the headquarters of their particular areas to order supplies. Many of the smaller societies are served by Co-operative Wholesale Society travellers, who represent the various departments, and who keep the local retail managers fully informed of changes in trading conditions.

(2) **Importing.** Many of the foodstuffs sold by the Co-operative Wholesale Society are obtained from abroad, so that the society is engaged on a big scale in the business of importing goods. As far as possible, supplies from overseas are obtained from co-operative producers, as in the case of Denmark, where bacon factories and butter depots have been established. In several countries, the

Co-operative Wholesale Society has given direct assistance to the co-operatively organised farmers. Examples of its activities on these lines are its participation in the New Zealand Produce Association, which is jointly owned by the Co-operative Wholesale Society and the New Zealand farmers' co-operative societies to market New Zealand produce in Great Britain; associations with the Canadian and Australian wheat pools; and trade with co-operative fruit growers in Palestine.

(3) Manufacturing. The Co-operative Wholesale Society operates some 140 factories and employs over 35,000 workpeople in the production of a wide range of the commodities which it distributes. No other undertaking in the country covers such a wide range of manufactures, and the number is constantly being extended. Co-operative production of this character is, of course, limited by the market offered by the retail societies.

(4) Banking and Finance. Co-operative finance in Great Britain can be divided into two distinct ventures—the Co-operative Wholesale Society Bank and the Co-operative Insurance Society. The Co-operative Wholesale Society Banking Department has headquarters at Manchester, with branches at London, Newcastle, and Bristol, whilst a number of Co-operative Wholesale Society depots and most retail distributive societies in England and Wales transact the simpler banking operations as agents for the department. The Co-operative Insurance Society, which is under the joint control of the Co-operative Wholesale Society and the Scottish Co-operative Wholesale Society, conducts all kinds of commercial insurance business for co-operative societies, whilst the customary life, accident, and property insurance services are provided for individuals.

RELATION BETWEEN WHOLESALE AND RETAIL SOCIETIES.—The diagram on page 238 serves to illustrate the relationship existing between the Wholesale Society and its members (i.e. the retail societies). The movement now engages in retailing, wholesaling, primary production, manufacture, transport, insurance, printing and publishing, and banking. The bank is not generally used by ordinary members. The retail stores keep their deposits in the Co-operative Wholesale Society Bank, as also do the trade unions. The legal and parliamentary side of co-operation is undertaken by the Co-operative Union, which holds its annual Congress during Whit-week.

It will be seen from the diagram that the Co-operative Wholesale Society is supplied by its own factories and workshops with the vast majority of the commodities which it sells to the retail societies. The profits earned by the Wholesale Society are distributed among its members (i.e. the retail societies) *pro rata* according to the amount of their respective purchases. These latter societies, in turn, divide their profits precisely on the same basis amongst their own members. Thus, a person who is a member of a co-operative store, say, in Bolton, will receive not only a share of the profits actually made in Bolton, but also a share of the profits earned by the Wholesale Society in Manchester.

PRESENT SIGNIFICANCE OF CO-OPERATIVE DISTRIBUTION.— There are many different views as to the significance of the co-operative movement as forming an integral part of the industrial system. These views may be grouped as—

1. Economic. 2. Social. 3. Industrial.

Economic Significance. The aim of the co-operative stores is to enable consumers to get what they want in their own way. With the elimination of the private retailer and wholesaler, there is less risk of the goods being adulterated, or of the inferior but more profitable brands being forced upon the consumers. Another economy is that the co-operators become their own shopkeepers, controllers, auditors, etc.

On the other hand, it has been said that the Stores may keep the customer waiting to be served, and that the co-operator gets less for his money than at the private shop, where there is a greater selection.

The goods at the Stores are sold at market prices. The advocates of co-operation hold that this method has advantages in that it shows the profits earned under the system in the form of dividend, and it also avoids friction with the private shopkeepers. The question often arises as to whether the dividends paid by the Stores are a measure of their economic superiority over the ordinary retailers. The answer of private traders is that the dividend is a delusion, and that the consumer loses, even after taking the dividend into account, owing to the inferiority of the goods supplied by the Stores. It is further argued that, in order to maintain a high dividend, the Stores charge more than the market price for certain articles.

Social Significance. In the first place, the Store is a training ground in self-government, since every member has indirectly a voice in the management. Any person over 18 years may become a member and possess a vote, although each member must hold at least one share in the Society. In many Stores a system of credit has been introduced, but the general rule is still cash payments. Moreover, it is argued that such co-operation encourages thrift and working-class investment, since the dividends might be regarded as a form of sub-conscious saving. Finally, the most important social advantage is the monetary sacrifice made by co-operators for the development of education among their members. Their expenditure has been mainly directed towards the furtherance of three branches of education—

1. General instruction in co-operative principles and history.
2. The establishment of libraries.
3. The provision of recreation (e.g. reading-rooms and excursions).

There is a Co-operative Political Party which works in close collaboration with the Labour Party.

Industrial Significance. It was not long before the retail societies had a surplus of capital, and they had either to reject the savings of the members or to re-invest them. This latter they could do either in the development of co-operation or in outside industrial concerns. The retail societies quickly became producers for all the simplest needs which were to be fulfilled near the place of consumption. As regards the production of other articles, power was given to the central agency—the Wholesale Society. The endeavour of the Wholesale Society has been to produce all those things which appear in the workers' budget, so that its productive operations are now very extensive. It manufactures its own flour, butter, biscuits, sweets, preserves, pickles, cocoa, chocolate, cigars, soap, boots and shoes, clothing, furniture, etc.; and conducts such operations as banking, milling, printing, and fruit-growing.

TEST PAPER

1. What are Co-operative Distributive Societies, and where have they met with the greatest amount of success?
2. Say what you know of the Rochdale Pioneers.

3. Explain the function of the Co-operative Wholesale Society.

4. What services are rendered to retail societies by the Co-operative Wholesale Societies?

5. In what manner do the members of a co-operative store participate in the profits earned by the Wholesale Society?

6. Write a short account of the organisation and administration of a retail distributive co-operative society.

7. Trace the evolution of the Co-operative movement in England.

8. Give an account of the modern growth and distribution over Great Britain of the membership of the retail distributive societies, so as to bring out the factors governing the increase of membership.

9. Can co-operation offer a solution to the problem of the equitable distribution of wealth?

10. Describe the ideal of co-operative industrial organisation according to: (*a*) the producers' theory and (*b*) the consumers' theory. What difficulties have been encountered in applying these theories to practice?

11. How do you distinguish between co-operative and capitalistic business? Has co-operation any capitalistic features?

12. What peculiar advantages are claimed for distributive co-operation?

13. What, in your opinion, is the significance of the Co-operative movement in the industrial system?

14. "The apathy of the rank and file of co-operative societies to-day is the greatest hindrance to the development of co-operation." Discuss this statement, indicating the methods you would employ to secure a greater intelligent interest on the part of the members in their societies and in the wider development of co-operation.

CHAPTER XXV

MARKETING

MARKETING is a very wide term, connoting the bringing together of sellers and buyers to complete transactions of sale and purchase of goods or of services or rights. It must be realised that between the raising of the raw materials and the eventual sale to the consumer of a product made from those raw materials, there will be many stages of sale and purchase. The cotton, grown perhaps in America, is sold to a producer of yarn in Lancashire. The yarn is then sold to a weaver of cloth. The cloth may be sold again for the bleaching and dyeing and printing processes, and the lengths of patterned cloth then be sold to a factory which mass-produces cotton dresses. From here the dresses may pass through a wholesaler's hands before reaching the retail shop at which the housewife buys a dress. Hence marketing is a process which is repeated frequently and at which goods in many different forms and stages of preparation are handled.

There are three main stages of marketing which must occur. Raw materials must be sold to the primary manufacturers by those who exploit the materials. In few cases will these primary manufacturers produce the finished article which is sold to the public. They will process the raw materials and then sell a semi-manufactured article which is the "raw material" of the producer engaged in making finished goods. Once the goods are in a state required by the eventual consumer, they must then pass through the retail market—which may be a direct one or may consist of wholesaling and retailing stages.

Moreover, marketing is not confined to goods alone. There must be markets for capital, for labour, for land and buildings, and for a variety of services required by producing and commercial concerns and by individuals. Wherever there is a supply of, and a demand for, goods or services, there must be facilities to bring suppliers and consumers together to make their bargains.

TYPES OF MARKETS.—In the same way that there are many forms of marketing, so there are many different types of market. A market need not exist in the physical sense of a central meeting place of buyers and sellers where goods can be seen and purchases negotiated.

Any organisation which puts buyers and sellers in touch with one another is a market, and the established contacts between dealers in various commodities and services through which, by letter, telegram or telephone, sales are negotiated, constitute a market in the economic sense.

The term "market" conjures up in most people's minds the street market or country town market where at known times buyers and sellers congregate and goods are available on display for purchase and immediate removal at prices negotiated on the spot. This is the simplest, and the original, form of markets. Retail shops and wholesale warehouses constitute permanent markets of this type although they will extend their services to mail-order sales or accepting telephoned orders and delivering the goods to customers who have not come to them to inspect the goods and make their purchases.

Localised and general markets of this type have tended to split into specialised sections, and often these sections have then moved away to form a separate market for certain types of goods. Billingsgate Fish Market, Smithfield Meat Market and Covent Garden Market for fruit and vegetables are examples, in London, of these specialised markets.

These are all examples of markets in finished or near-finished goods which will be fairly local in their span and which will demand that buyers and sellers be in close contact with one another. In Smithfield and Billingsgate, however, agents may buy on behalf of and despatch the goods to principals in the provinces.

In the wholesale market for finished goods and in the market for semi-manufactured goods, however, the span of activity may be much wider, and there may be no central meeting place for buyers and sellers other than the showrooms maintained by wholesalers and manufacturers for such of their customers as may be in the locality, or may wish to visit the sellers to discuss business. The wholesaler maintains a staff of outside travellers who cover allotted territories, visiting potential customers with samples of the goods available or following up the despatch of illustrated and detailed catalogues. In marketing semi-manufactured goods such as steel ingots, bars, plates, sheets or wire, or woollen and cotton cloths, the market is a fairly well defined one since these goods can be sold only to a limited number of firms engaged in further processing these materials. Here again, therefore, contact may be by letter or telephone communication,

by travellers' visits, or by personal visit of the buyer to the primary manufacturer.

Such sellers, and also manufacturers of finished goods, who wish to make contact with a potential wider market, may also participate in Exhibitions or Fairs held periodically for the purpose of bringing goods to the notice of a wider public. These may be local, national or international in their impact. The British Industries Fair, for example, was a "shop window" for a wide variety of home-produced goods which attracted many foreign buyers to this country to see what our industries had to offer. Samples or special displays may also be sent by British manufacturers to Fairs held in other countries in order to attract export orders.

The markets for raw materials usually have established centres in the form of Produce or Commodity Exchanges at which importing merchants or dealers sell to principals or agents buying on behalf of the consuming industries. The Commodity Exchange in Mincing Lane, the Metal Market, the Wool Exchange, the Fur Exchange, the Baltic Exchange and a variety of such markets exist in London, and there are also provincial exchanges throughout the country for this purpose. Here the buyers and sellers congregate and through the medium of samples, or established grades, effect deals in large quantities. If the commodity dealt in is incapable of accurate sampling or grading, then the deals will usually take place on the basis of selling by auction. The different types of sale and the conditions attaching to them have already been dealt with in Chapter XIX.

In the same sense that these are markets for physical goods, so the Stock Exchange is a market for British Government Stocks and for the stocks and shares of public joint stock companies. The Commercial Banks and the Discount houses and other financial organisations constitute a "money market." Lloyd's and the Insurance Companies form an insurance market. These are organisations through which the demand for, and supply of, services may be brought together.

Depending on the extent of the supply of and demand for goods and their transportability, markets may be very narrow and local or very wide and international. Wheat is grown in many parts of the world and wanted all over the world, and the marketing institutions for this commodity endeavour to bring about an equation of world supply and demand and to steady prices all over the world,

subject to the incidence of transport costs. This cannot now be done to the same extent as was possible before the war because of the restrictions on the convertibility of currencies. The totalling up of the effect of supply and demand in a number of separate markets and the closing of price gaps are brought about by arbitrage operations—buying goods in a low-price market and reselling them in a high-price market. The operator makes himself a profit of the difference in price subject to transport and handling costs, the supply and demand in the separate markets are brought nearer to equation and the price gap is closed.

The majority of marketing deals of the type enumerated will be "spot" transactions—i.e. deals negotiated at prices determined by current supply and demand conditions, in which the goods will immediately be delivered and used. Specialised dealers on many of the commodity exchanges will also, however, undertake "future" transactions. That is to say they will undertake to deliver agreed quantities of a commodity at a future date for a price agreed now. A manufacturer may wish to ensure his supplies of raw materials for future working and know his costs well in advance so that he can determine his planned production and costs and fix a profitable selling price. He may prefer not to take the risk of buying supplies as and when he needs them on a fluctuating market which may bring about wide variations in his cost and cause him to make frequent changes in his selling price. He therefore goes to a specialised dealer who is prepared, with his expert knowledge, to anticipate the future supply and demand positions and probable price trends, and to quote a price now at which he will supply goods at a future date, which goods he himself will buy on the spot market when the time for delivery comes. He will naturally fix the price at a level which he anticipates will give him a profit over the future spot price, but if he is wrong in his anticipations then he will be obliged to fulfil his contract at the future date even though this means his buying at a loss.

REQUISITES FOR A DEVELOPED MARKETING SYSTEM.—Exchange of goods occurs in the most primitive of societies, and trade between nations has flourished throughout history, but under modern capitalism marketing has become the central feature of the whole economic system. For marketing to attain this position, certain institutions are pre-requisite. The most important are private

property—both in goods and in one's own person—freedom of contract and diffusion of property rights.

Given these basic institutions, certain devices are necessary to carry on the specific economic activities which constitute marketing. First, there must be devices for accomplishing transfer of ownership. In a developed form, this implies a vast system of law and recording. Equally fundamental are mechanisms for price determination. Prices can be determined by the higgling of individual buyers and sellers, but this process is usually least costly when aided by such facilities as those provided by commodity exchanges.

Another essential to the organisation of specialisation by marketing is widespread information concerning the activities of specialists, and concerning the existence of supplies, desires, methods of transport, and localities in which trading can be done to advantage. Agencies for fixing standards of quality and for grading represent subsidiary aspects of the information function in the modern marketing system.

MARKETING FUNCTIONS.—Broadly speaking, the marketing process may be said to comprise two major activities—the concentration of economic goods, and their distribution or dispersion to the final consumer. Many raw materials, notably agricultural products, are produced at a large number of relatively small sources of supply, and need to be brought together in centralised markets in order that the various marketing processes may be performed efficiently. These concentrated supplies are then dispersed through the various channels of trade to the ultimate consumers who require them. In the performance of this work, some or all of the following services may be performed—

(1) **Assembling.** This function may become necessary when the producers of a commodity operate only on a small scale, and are scattered over a fairly wide area. In such circumstances it may be necessary to concentrate supplies in bulk before proceeding with other marketing services in order to secure economy in handling. This is often found to be the case in the marketing of agricultural products. The same function may be performed in the case of manufactured goods where a dealer assembles a group of different commodities of a similar class for the convenience of his customers. The wholesale grocer, for example, may assemble in his warehouse

a wide range of commodities obtained from different manufacturers in order to meet the requirements of retailers. This work of assembly may present special difficulties and call for exceptional skill in the following cases—

(*a*) Where the producers or manufacturers are numerous, small, and scattered.

(*b*) Where the commodity is little standardised, and is subject to considerable variations in quality.

(*c*) Where supplies are seasonal or irregular in character, thereby causing difficulty in the maintenance of stocks.

(2) **Grading and Standardising.** This marketing service is mainly of importance in connection with agricultural products, since manufactured goods are standardised in the process of production. The service of sorting out products into groups of uniform kind, quality, and size is known as grading. Standardisation aims at making it possible to give permanence to grades over long periods of time. The effect is to give confidence to buyers and to consumers generally, to lessen the volume of waste, and in general to pay the producer according to the quality of his produce, as well as to increase the demand by lowering his costs and by encouragement of the consumer through the sale of a definite article. Standardisation means, in effect, a widening of the market. Without a description that conveys the same concept of a product to both buyer and seller, it would be impossible to make a deal unless the goods themselves were at hand and inspected. If it were always necessary to examine produce before making a sale, it would be impossible to deal in futures. In order to buy goods to be delivered at some future date, it is necessary to have some means of stating clearly what is being bought, and for products which are capable of being graded, the grade is the means of making such a statement.

(3) **Packing.** This function is frequently associated with manufacture rather than with marketing, but this is by no means invariably the case. Large national wholesalers, for example, not only grade and sort the merchandise in which they deal, but very frequently repack it under their own brands. Even small wholesalers have to unpack and repack most of the goods they handle. Not the least expensive part of the average wholesale business is the "broken package room," where orders from retailers, in quantities smaller than the manufacturer is prepared to pack separately, are made up.

Packaging alone makes possible the branding and advertising of products, such as tea, coffee, rice, etc. Packaging has given such goods individuality, since the manufacturer can advertise them and the public can identify them. In this way packaging has opened up new avenues of sale, and has enabled manufacturers to create demand in advance.

(4) **Processing.** This function may be regarded as a manufacturing activity, since its primary purpose is to give a *form utility* to a commodity. Yet, inasmuch as it is often performed by a distributor, some mention of it is required. In the first place it may include conversion services performed on agricultural products, such as cheese-making, preserving fruit, or curing bacon. It may also take the form of a reduction of the bulk of commodities in order to make them more readily transportable, or the working-up of by-products. In certain food trades there exist certain specialised types of wholesalers whose principal function consists in buying different grades and qualities, and blending them in proportions which will provide an article acceptable to the consumer. Thus, there is the butter blender, the well-known tea blenders of Mincing Lane, while similar specialists exist in the coffee and other trades. Again, repairs and alterations undertaken as a subsidiary process in order to make goods saleable are obviously to be classed under the heading of distribution rather than production. This is true of the alterations department of an outfitter who sells clothes ready-made, but is prepared to make slight alterations to make them fit the purchaser.

(5) **Market Research.** The object of market research is to secure information to aid in formulating and carrying out selling policies. It is concerned with a product in its relation to consumers, and covers not only the qualities of the product and the way it is packed, but the prices at which it is sold and the ways by which it is distributed to the public. There are various ways in which such investigations and experiments may be conducted. Trained investigators may be sent out to interview wholesalers and retailers or members of the public in their own homes, or questionnaries may be sent out through the post. Manufacturers may set up "laboratory shops," and use them as a means of collecting information about the demand for their own and their competitors' goods. New lines may be launched under controlled conditions or in sample areas, and the resulting sales analysed before an attempt is made

on the market as a whole. The manufacturer or distributor who makes a wise use of these methods is likely to secure enormous economies in distribution, and escape a great deal of avoidable waste.

(6) **Salesmanship.** The chief objective of this stage of the marketing process is to bring a potential buyer into contact with a seller in such a way as to bring about a transfer of goods. The true salesman renders service both to his customer and to his employer. He serves his customer by aiding him in the wise choice of goods which will best meet his requirements; he serves his employer by helping him loyally in the task of marketing his product without damaging the employer's reputation. As a result of this process there has been created what is termed "personal utility," which arises from the fact that economic goods are in the possession of a person who wants to consume them. If it were not for the activity of the seller in bringing to the attention of the buyer knowledge of new products that will meet his needs, the consumer might go on for an indefinite length of time in ignorance of the existence of such goods.

(7) **Advertising.** Complementary to the foregoing function is that of advertising, which is an indispensable feature of modern marketing. The purpose of advertising is to sell, or to help to sell, goods, ideas, or services. Making a sale may involve many factors: arousing desire or creating demand; finding a buyer; negotiation of terms; giving advice or information, so that the buyer can use the product satisfactorily; and transfer of title. Underlying the problems of both salesmanship and advertising, we have the psychology of the consumer, but whereas the salesman considers each customer as an individual problem, the advertising consultant must consider them as a group and make his appeal accordingly. Advertising, in a general way, may be said to perform a two-fold function, viz. that of retaining the goodwill of existing customers, and that of securing the patronage of new ones. Advertising may be undertaken—

(*a*) To increase the sale of a given product or class of products without regard to individual producers. This can be done by co-operative advertising. E.g. the "Say it with flowers" and "Beer is best" campaigns.

(*b*) To promote the sale of the goods of an individual seller by diverting trade from competitors.

(c) To inform the public of the production of an entirely new article which involves the creation of a new demand.

(8) **Transport.** Transport is the physical means whereby goods are moved from the point of production to the place where they are required for consumption, and, under modern conditions of specialisation, this function lies at the root of the whole marketing process. Heavy expenditure on transport is a necessary consequence of specialised and large-scale production, and is peculiarly characteristic of modern industry. There can be no real market, other than that of a local nature, unless goods can be moved safely, quickly, and at a cost which is not prohibitive. Under present conditions, the carriage of finished goods is performed partly by specialised agencies, such as railways, steamship, and other transport undertakings, and partly by manufacturers and traders who organise their own road transport departments.

(9) **Storage.** Goods are transported from producing points to consuming markets, but after reaching the consuming market it is often necessary that they be stored until needed by the consumers. This function of holding the goods from the time they are produced until they are needed for consumption—the creation of time utilities—is just as necessary for the satisfaction of human wants as was the original production of goods. The existence of storage facilities enables producers and distributors to hold stocks at points convenient for regional distribution. Such stocks enable the seller to make quicker deliveries to buyers at distant points than if goods had to be shipped from the main plant. The buyers can carry smaller stocks and utilise their capital to better advantage. This aspect is particularly important in view of the modern tendency towards small-scale buying on the part of retailers. Storage is sometimes a service which is performed by special companies, though this is more often true in the case of raw materials at the port of landing and elsewhere than of finished commodities. A limited amount of storage must inevitably be undertaken by manufacturers, unless they make solely to order; and by retailers, unless they are merely acting as manufacturers' agents and conduct their business entirely by pattern or specification.

(10) **Finance.** Modern methods of production and marketing necessitate a considerable delay from the beginning of the production process until the finished product reaches the user. Generally

speaking, the consumer, from whom the payment for the product is received, will not advance the money for the payment for the article until it is delivered. Provision for supplying the funds necessary must be made. The service of providing the credit and money needed to meet the costs of getting merchandise into the hands of the final user is commonly referred to as the finance function in marketing. The more familiar sources of finance are the commercial banks, commercial paper houses, and finance companies, which are all concerned mainly with the provision of short-term capital. The financial service may be given to the producer, to the merchant, or to the buyer. When we consider the case of the marketing of goods in the import and export trade, the finance function becomes both important and complex, since the geographical distance between buyer and seller, different national currencies, and the need for granting extended credit, impose special difficulties.

(11) **Insurance.** The ownership of property carries with it certain risks, and since marketing has to do with the transfer of ownership, it is obvious that risk and risk-bearing are involved. The goods may be destroyed by fire, stolen by burglars, damaged by floods, losses may result from a fall in market prices, the goods may be rendered unsaleable by a change in demand perhaps resulting from a change in style or improved designs being placed on the market, goods may be sold on credit and bad debts incurred, or competition may render it impossible to sell goods at a profit. Many of these risks may be taken over by professional speculators, whilst others are assumed by the trader himself. In a period of great uncertainty, due to such a factor as currency instability, a trader in, for instance, dress materials, may safeguard himself against violent fluctuations by effecting a transaction in raw wool or raw cotton futures to offset his purchases of finished goods. More commonly, however, he himself shoulders the risk of changes in the value of his stocks after he has purchased them, and protects himself as best he can when prices are on the down grade by reducing his holdings to a minimum at such times.

TYPES OF COMMODITY MARKETING.—When we consider the question of the marketing of material commodities, we are faced by a series of problems which are by no means uniform in their application. The commodities which flow through the channels of trade are of a diversity of types and are destined for a variety of uses.

Some come from widely dispersed sources of supply, whilst others are produced on almost monopolistic terms; some are marketed to consumers all over the world, whilst others are required by a very limited number of buyers. Each commodity, therefore, tends to have its own characteristic mode of distribution in the light of these relevant facts, but for the purposes of generalisation we may reduce them to a number of classes, of which the following are examples—

(1) **Primary Products.** These include the products of the extractive industries, such as agricultural produce, minerals, forest products, and fish. The distinguishing feature of the members of this group is that they are taken directly from nature and turned into the channels of industry. Moreover, in the great majority of cases some preliminary work on them is necessary before they are available to the consumer. Many of these commodities are dealt with on the *produce exchanges* which include some of the most important markets in the world. Each is characterised by being centralised in some important city, though embracing practically the whole world in the scope of its operations. For instance, the Corn Exchange in Mark Lane is devoted to the sale of all sorts of cereals and agricultural seeds; tea, coffee, cocoa, and rubber are disposed of principally at the Commodity Exchange in Mincing Lane; wool is sold at the Exchange in Coleman Street, London, and also at Liverpool and Bradford; whilst fruit and vegetables find their chief sale at Covent Garden. *Auction sales*, again, are of considerable importance in the wholesale trade in certain commodities, such as fruit, wool, and furs.

(2) **Semi-manufactured Products and Manufactured Parts.** These possess the common characteristic that although certain industrial operations have been performed upon them, they are not yet available for the final consumer. Manufactured parts are articles which are incorporated, without modification, with other materials or parts in the completed products. These range from the pressed metal parts used in the manufacture of electrical meters and calculating machines, to glass insulators and containers, motors for vacuum cleaners, and motor-car bodies. The market for these parts is essentially a *vertical market*, that is, a market by industries rather than by functions extending through diverse industries. In the case of a manufactured part like a motor-car body, the market is found only in a single industry. A company manufacturing pressed metal

parts on the other hand, finds its market in a series of industries, but the purchases in all cases are made with reference to a single industry. Semi-manufactured products also become part of other manufactured articles, but undergo physical modification in the further processes of manufacture. Examples of these are steel plates and rods, copper wire, leather, and book paper. The market for these materials is again usually a vertical market by industries. Some such materials find use in various industries as, for example, copper wire, but for many materials the market is confined to a single industry, as in the case of wool tops.

(3) **Manufactured Consumers' Goods.** Under this heading we may include the great bulk of the goods which are purchased by the final consumer. They comprise the necessities, comforts, and luxuries of life for which the consumer pays more than £10,000,000,000 per annum in this country. The goods purchased by the final consumer are mainly marketed through some form of retail concern, but the channels whereby they reach the retailer are both numerous and complex. The small-scale demand of the individual consumer necessitates convenience and accessibility in the location of the store, and a variety of grades, styles, sizes, designs, prices, and other qualities. Furthermore, a number of services, such as credit, delivery, demonstrations, repairs, and many others which the manufacturer cannot economically give, are expected by the consumer. Hence a large number of retail outlets exists for disposing of these consumers' goods, including the independent retailer, multiple shops, departmental stores, mail order houses, and co-operative retail societies. Again, a considerable volume of produce, mainly of a perishable type, is distributed to the consumer by itinerant traders.

(4) **Capital Equipment.** This includes manufactured goods bought by producers, merchants, and institutions, not for resale, but for the purpose either of aiding in the production of their product, e.g. factory and office equipment, or of adding to their equipment or maintaining it. The selection of such equipment is governed by the product which is to be turned out by the plant, or by the nature and scope of the operations to be performed. The market for installation is one in which repeat demands are infrequent. It's purchase requires capital expenditure, and is governed in large measure by general conditions in the particular industry in which

the equipment is to be used. In the sale of complete plant installations, engineering and designing service is of importance. The market for capital goods of this type is extremely specialised, and is usually limited to one industry. Accessory equipment is the auxiliary or supplementary equipment of a plant; it serves to facilitate the operation of the main installation, to aid in carrying on administrative and auxiliary services, and to assist in the performance of other miscellaneous tasks. Examples of accessory equipment are small motors, tools, time clocks, conveyors, factory trucks, and steel shelving. The market for an item of accessory equipment cuts across many industries. In approaching this market, therefore, it is necessary for a manufacturer of accessory equipment to ascertain the types and sizes of firms which are potential purchasers, and to exclude from his sales programme those firms which are too small to use the products which the company produces.

TEST PAPER

1. What is a "market"? What conditions are necessary in order to ensure a wide market for a commodity or service? Name some of the chief markets, and state the purpose for which they are used.
2. Enumerate some of the marketing problems which arise from the separation of the producer from the consumer.
3. Name four important functions of marketing, and state the causes which give rise to the need for each of them.
4. Show how the assembling of goods is affected by the scale of production, and the extent of division of labour.
5. Mention as many factors as you can think of which must be kept in mind in choosing a package for use in distributing a product through the retail trade.
6. What part is played by (*a*) market research, (*b*) salesmanship, (*c*) advertising, in the marketing of goods?
7. Certain areas in London are world-famed as markets for specific products. Name the principal markets and describe, in some detail, the activities of one of them.
8. Analyse the influence which developments in the grading of a product have upon the organisation of the market for that product.
9. Discuss "grading" as an aid to the marketing of products, and give illustrations of recent practice in this direction.
10. Outline the principal marketing functions which may be performed by training intermediaries in the distribution of goods from producer to consumer.
11. "Marketing does not really help. Indeed it hinders. Time and energy are spent in merely passing goods on." Comment on the correctness or incorrectness of this statement.

CHAPTER XXVI

The Middleman and His Functions

It has been seen in an earlier chapter that there are three main groups of persons who enter into consideration when dealing with trade: the producer, the trader, and the consumer. The trader's function, which was formerly exercised by a single person, is to effect the exchange of the goods by purchase and sale; and, under normal circumstances, this is now subdivided into three divisions: the *collecting*, the *distributing*, and the *intermediary* trader. As the growth in the variety and complexity of trading operations necessitates a more extensive division of labour, this is expressed in the increase of members in each of the three main groups. In actual practice, it often happens that goods in their distribution from the producer to the consumer change hands five, ten, or even more times, in such a manner that (just as fire buckets and bricks are passed from one person to another) the individual members concerned work hand in hand.

In addition to the various intermediaries which assist in the transference of goods from place to place, there is a large number of necessary and allied activities, such as the methods of payment and financial facilities, warehousing and insurance, the supply of information concerning the standing of clients, etc. In this way, there is brought into existence an extensive division of labour for effecting the exchange of the goods, so that the trade organisation may be compared with the links of a chain, since the function of one individual forms a connecting link with the others.

FUNCTIONS OF THE MIDDLEMAN.—The term "middleman" in its widest connotation embraces all those who intervene between the primary producer and the ultimate consumer in the exchange of commodities. It is sometimes confined, however, to the mediating links which are inserted between the wholesale and the retail trade which we have already described as *intermediary* traders. They include dealers, wholesale merchants, manufacturers' agents, factors, and similar undertakings which sandwich themselves in between the wholesale and retail trade, or between the manufacturer

and the wholesaler. In addition to the ordinary functions of buying and selling, the middleman may perform some or all of the marketing functions explained in Chapter XXV. Thus, it is the function of the middleman, working in the producing area, to buy up supplies from scattered producers and concentrate them at certain points before distribution in the area of consumption can be economically carried out. The middleman must, in his own interest, divert the goods to the most favourable market for them. An irregular flow of goods to market causes wide price fluctuations, resulting in losses to dealers and having an undesirable effect on buyers.

The middleman can also utilise existing transport facilities to the best advantage by forwarding in bulk in order to take full advantage of special freight rates and other concessions. Goods are transported from producing points to consuming markets, but after reaching the market it is often necessary that they should be stored until needed by the consumers. Storage has always been recognised as a fundamental economic service in the smoothing out of supplies. Moreover, it is not always possible for the producer of goods to wait for his money until the consumer pays for them. Frequently this function of waiting is performed by the middleman, who takes the goods from the producer and pays for them within a short period, retaining possession of them until he can dispose of them. Even after disposal he may still finance the goods through extended credit. He may also render such specialised services as grading, packing, and processing.

Example of a Middleman. A good example of a middleman engaged in the home trade is the *coal factor.* The National Coal Board sells its coal direct to a factor who disposes of his supplies to smaller dealers and distributors. The business of the Coal Board is to get coal to the surface. The business of removing that coal from the pit-head and financing it until it can be delivered to a consumer is quite a different function from that of coal-mining. It can be performed by the Coal Board itself. The factor performs a function exceedingly useful, and indeed vital to the coal industry, but imperfectly understood by the general public. It is he who facilitates the business of those smaller merchants, who meet the needs of the public. In many cases he actually finances the coal from the time that it is brought to the pit-head until the time that these

smaller merchants can take delivery of and distribute it. It is necessary for the conduct of the trade that a certain supply of coal should always be available to meet current demands or an unforeseen emergency. This means that somebody, in practice the factor, must purchase a quantity of coal and, in addition to taking the risk of the price at which he may be able to dispose of it, must hold it for a period running from days to weeks, during which period he will receive no interest on the capital he has sunk in the purchase of the coal.

In many cases the factor provides the wagons in which the coal is removed from the colliery. In other cases he steps in to remove congestion, either at the pit-head or in the railway sidings, by purchasing a number of wagon loads of coal at a time when the market is very slack, and, by his knowledge of the markets all over the country, distributing the coal wagon by wagon, and thus enabling the collieries to continue production. For that service to the Coal Board he doubtless receives, and is entitled to, a concession in the price that he pays for the coal.

Besides giving his buyers the benefit of his intimate knowledge and experience of the particular coalfield, the factor may also undertake the grading and cleaning of coal, both for household and industrial purposes. Thus he ensures that only those grades of coal are supplied which will meet the special requirements of his customers.

INCREASE AND DECREASE OF MIDDLEMEN.—In the organisation of trade, two striking tendencies are noticeable—

(1) The tendency for a larger and larger number of middlemen to assist in the conduct of trade (i.e. division of labour).

(2) The opposing tendency to eliminate existing middlemen.

These two tendencies can best be seen in the sphere of *manufacture*. In the Lancashire cotton industry, one firm spins yarn; another buys and weaves it; and the goods are dyed, bleached, or finished by a third firm; and marketed by a fourth. On the other hand, the large woollen manufacturing firms sort, dye, and prepare their own wool or other raw material; spin, weave, mill, dye, finish, and market their own goods. The question arises as to which is the better system of the two: that which prevails in the cotton trade and, to some extent, in the worsted trade; or that which prevails in the woollen industry? Some say one

system and some the other. Among the advantages of the combined system there is—

(1) Greater unity of purpose (e.g. the wool buyer has in his mind not merely the making of a yarn to sell, but the production of the best result in the finished cloth).

(2) There are various economies of service: the cost of extra books, and buying and selling apparatus between one department and another, is saved.

(3) A business organised on a large scale can afford to buy large and expensive machines.

(4) Greater expedition in quickly executing large orders for large customers.

(5) The system enables the departmental managers to specialise more highly each in his own department.

Against these advantages there are certain inevitable disadvantages—

(1) The absence of a check upon the cost of work in any particular department which the putting out of work secures.

(2) The difficulty of securing efficient central management. Without this essential, a large business becomes unwieldy and less efficient.

Both those tendencies, although opposed to each other, are based upon the same principle. It is the striving after greater economy with the object of securing a greater return to the capital invested.

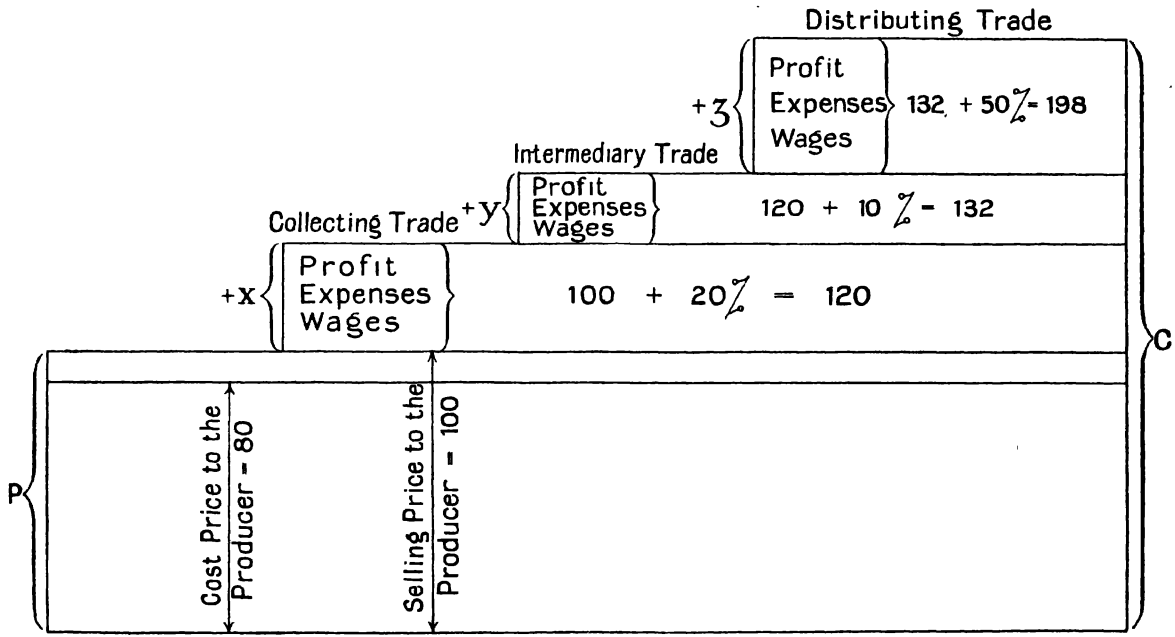
These same conditions also exist in *trade*. Every trader who desires to establish a business has two ways open to him—

(1) He can set up his new undertaking alongside others of the same kind, thus entering into competition with them; or

(2) He can endeavour to enter as a useful and indispensable link in the existing chain of organisation.

If he chooses the former method, his business prosperity will depend upon whether he is triumphant in the competitive struggle, and this can be attained only by effecting a cheaper and more economic exchange of goods than his competitors. He must, therefore, ever be on the alert to discover the best and cheapest sources of supply, so that he can effect his sales in the best market. In this endeavour he is often led to skip over certain members in the trade organisation wherever such a course of action offers an advantage.

THE ELEMENTS WHICH CONSTITUTE PRICE



The tendency to exclude certain links in the chain of exchange usually arises from the action of traders themselves, but it may also take place owing to the action of producers and consumers. This latter phenomenon will now be examined.

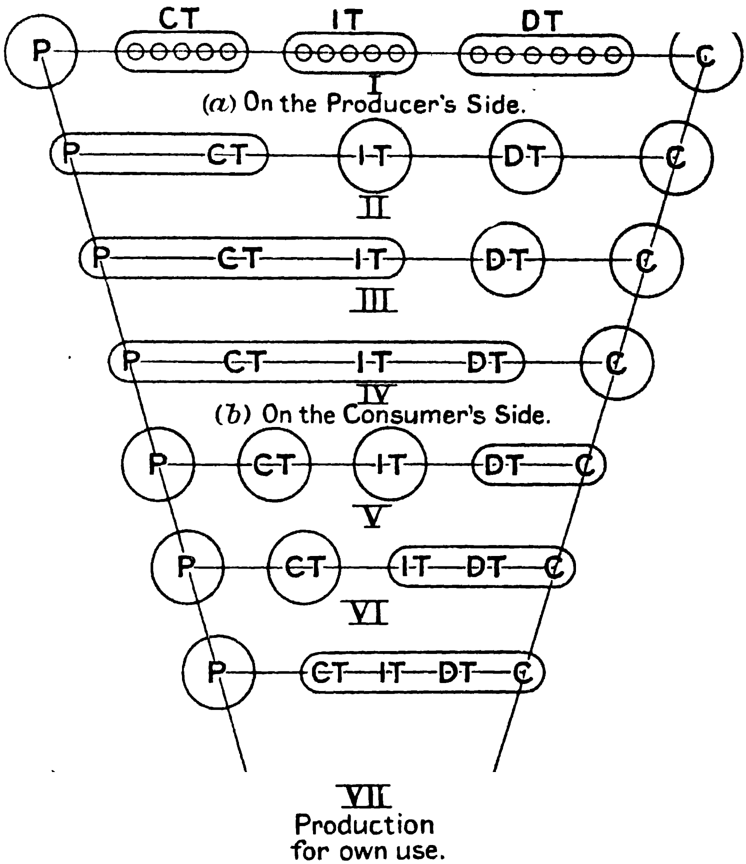
EFFECT OF MIDDLEMEN ON SELLING PRICE.—As already explained, each new link in the chain of trade organisation creates a new set of opposing interests, since there is involved an additional sale and purchase, for the goods have to pass through the hands of another middleman. Naturally, each additional member increases the selling price, and each increase is usually made up of the total of his expenses (i.e. the remuneration of his labour) and the profit as a return for his risk. The consequence of this is that each new opposing interest must also increase the price of the goods, as is seen in the diagram on page 261.

The expenses of the process of distribution fall ultimately upon the producer and consumer, both of which benefit by any progress in trade organisation, in the mode of transport, or in the diminution in the number of middlemen. Thus, any increase in the expenses of distribution caused by the increase in the number of middlemen falls as a burden upon the producer, in the sense that the increased price will affect the market for his goods, and the consumer, who has to pay a higher price.

In many directions there is a tendency at the present time to eliminate rather than to engage a larger number of middlemen. Farmers, manufacturers, and even retailers, organise themselves, in many cases, for the purchase, in common, of raw materials, machinery, seeds, manure, etc. The tendency is for them to trade direct with the wholesale dealer. On the other hand, the consumers organise themselves in co-operative societies, with the object of personally effecting their own purchases. Their aim is to exclude the retail dealer. Further, on the great centralised produce exchanges, rings and other powerful groups of speculators are formed, whose endeavour is to monopolise the world market in some particular commodity, such as cotton, copper, wheat, silver, etc. In this way, they hope to weed out those persons who have previously carried on business in that particular branch of trade.

METHODS OF ELIMINATION.—The various methods of elimination are best illustrated by the diagram on page 263.

METHODS OF ELIMINATING MIDDLEMEN



P . . Producer
C . . Consumer

C T = Collecting Trader
D T = Distributing Trader
I T = Intermediary Trader

I. Producer combines Sale of Goods and function of Collecting Trade.
II. Producer deals directly with Distributing Trader and thus eliminates Collecting and Intermediary Traders.
III. Producer establishes Stores or branches, and serves direct (e.g. typewriters, shoes, etc.).
IV. Consumer eliminates Retailer and buys direct from Wholesaler.
V. Consumer buys directly from Collecting Trader, and thus eliminates Distributing and Intermediary Traders.
VI. Consumer buys directly from Producers (e.g. Mail-Order Business and Co-operative Society).
VII. Consumer links Co-operative Consumption with Production.

Stages I, II, and III represent the efforts made by the producers to eliminate certain of the middlemen. In the *first stage*, the collecting trade is omitted, so that the distribution is effected direct with the intermediary trader.

In the *second stage*, the intermediary trader is omitted as well as the collecting trade, so that direct relations are entered into with the retailer. In this way, manufacturers seek to deal direct with the retail trade.

In the *third stage*, the manufacturer opens shops for sale direct to the consumers. The whole of the trading operations are thus linked on to the production, and the independent traders become dependent organs in the service of the manufacturer or other producer.

The stages marked IV–VII show the attempts to eliminate on the part of the consumers.

Stage IV illustrates the omission of the distributive trade by the establishment of co-operative societies.

Stage V shows the exclusion of the intermediary trade by direct intercourse with the collecting trader, as in the case of State undertakings.

The last and *highest stage* consists in the complete elimination by the consumers of all opposing interests, so that the societies of consumers absorb the process of production, and have, as their aim, production for their own needs. The beginnings of such a system are to be seen in the establishment of the large factories and workshops in connection with the English Co-operative Wholesale Society.

Recent changes in the distribution of the population of Great Britain emphasise the importance of the services of the middleman. They undoubtedly constitute an essential part of the total cost of production. The people who perform these services may be supplanted by other individuals or groups, but the services themselves must be continued. We may speak of eliminating the middleman, but we cannot dispense with the services he performs. They are a vital part of the mechanism of production. But we may reasonably ask whether these services are being conducted in the most efficient manner. The system of private enterprise must stand the test of efficiency and the community has a right to object if any set of producers or traders is not efficient.

TEST PAPER

1. In what respect may the organisation of trade be compared with the links of a chain?

2. The middleman has been the target of the most vicious attacks. It has been charged that he collects a profit from the distribution of goods without rendering any service for it.
(*a*) Do you agree with this charge?
(*b*) If not, enumerate the services which he does perform.

3. How far do middlemen co-operate to assist in the preparation of goods for sale (i.e. in sorting, grading, blending, etc.)? Explain by one or two commodities with which you are familiar.

4. Explain in detail the services performed by a typical middleman engaged in some branch of the home trade.

5. Mention the advantages and disadvantages of conducting a variety of manufacturing processes under one management.

6. Enumerate the advantages to be gained from specialisation. Illustrate your answer by reference to the organisation of the Lancashire Cotton Industry.

7. Give illustrations of some of the methods by which middlemen are eliminated.

8. Give two concrete cases to show that both "producers" and "consumers" are instrumental in squeezing out the middleman.

9. Outline the chief reasons for the decline in importance of the middleman in certain trades, and for his increasing importance in others.

10. Describe carefully the services rendered by the wholesaler to the retailer. Name instances in which the wholesaler is omitted in the passage of goods to the retailer from the manufacturer.

11. In what ways are "middlemen" useful to commerce? Illustrate by reference to some class of middlemen with which you are acquainted.

12. Give some examples of sale direct to consumers by manufacturers and discuss why this method of distribution is not adopted more generally.

13. Do you know of any instances in which the wholesaler is passed over in the passage of goods from manufacturer to retailer? What do you consider to be the reasons for the omission?

14. "It is the merchant rather than the maker who is the hub of the modern economic system with its dependence on the mechanism of price." Refute or justify this statement.

15. "We may speak of eliminating the middleman, but we cannot dispense with the services he performs." What are these services?

16. Indicate the services to the community performed by the dealer or middleman. Show how errors may arise concerning the nature and amount of his gains.

CHAPTER XXVII

THE RISKS OF TRADE AND THEIR DISTRIBUTION

THE solution to many of the problems connected with *direct* purchase and sale is based upon a proper understanding of the various kinds of risk and their distribution over the various members of the trade organisation. These risks are mainly connected with the following—

1. Price
2. Credit
3. Rates of Exchange
4. Delivery
5. Quality
6. Fluctuations in the volume of Trade

PRICE RISKS.—A glance at the movement of the market prices of various goods shows at once that prices are subject to great fluctuations. These are the greater, the more these goods resemble raw materials; whereas the further the commodity progresses in the stages of manufacture and approaches its complete state, the smaller do the fluctuations become.

After a consideration of the immense stocks which must always be at the disposal of trade on the world's market (e.g. two years' supply in the case of wool and at least one year's supply of American cotton and Brazilian coffee), it can easily be seen that a 10 per cent alteration in price changes enormously the total value of these available stocks.

As every trader who has accumulated a stock of goods for a shorter or longer period gains or loses with each fluctuation in price, it follows that a risk is thus involved.

Leaving out of consideration the quantity of stock concerned, this risk increases with the length of time between the purchase or manufacture of the goods and their sale or consumption, combined with the number of fluctuations in the particular commodity. Although many of these risks can be thrown on to other members of the trading organisation, the trader cannot avoid them entirely. Again, if the risks are borne by a number of persons instead of by a single trader, it must be remembered that the risk is still in existence, although it is distributed in a different way. From

this it will be seen that the greater the number of risk-bearing middlemen, the smaller does the price risk become in respect of each individual trader. Every additional member engaged in the work of distribution bears a part of the total risk, and this diminishes the amount borne by other members. On the other hand, if a middleman is eliminated from the trade organisation, the risks he has hitherto undertaken must be borne by the new member, who has assumed the execution of the work. Hence, the trader who buys and sells direct, without the aid of a middleman, undertakes a greater risk in connection with price fluctuations.

CREDIT RISKS.—Every independent trader through whose hands goods pass is, at one time, " buyer " and, at another, " seller." If the transaction is not concluded immediately, there arise credit conditions, so that one person is the debtor, whilst the other is the creditor. For the trader granting the credit, a risk is involved, which increases with the length of time between the date of purchase and that of payment, and with the increase of distance between creditor and debtor. If business is transacted directly with customers without the intervention of intermediaries, the credit risks on the part of the direct seller will increase. If trade is effected direct, say between manufacturer and consumer, the organisation for protecting credit is dispensed with. Thus, the experience of hitherto existing traders, and their system of organisation and specialised knowledge, as well as the service of inquiry, etc., are eliminated, so that the risks devolving upon the manufacturer or producer must necessarily increase.

EXCHANGE RISKS.—If both buyer and seller reside in different countries, each of which possesses its own system of currency, there arises the need for collecting the price of the goods at exchange rates.

It is evident that, with the elimination of the middlemen, the risks caused by fluctuations in exchange rates are by no means abolished, but they are merely readjusted so that they devolve upon the person who takes over the work hitherto connected with that risk.

Hence, in the case of a more direct policy of purchase or of sale being adopted, the risks connected with the exchange rates, and formerly borne by middlemen whose services were involved, will now be undertaken by the person engaging in direct trade. From

an economic point of view, it is immaterial which party bears this risk, although it may be that the eliminated middleman is able to exercise more skill in utilising the state of the exchanges than the member who takes his place, or vice versa.

DELIVERY RISKS.—The adherence to the date of delivery constitutes a very important factor in trade. If the goods ordered are not delivered at the proper time, an immense loss may ensue to the parties concerned. Every member in the trading organisation is in this respect dependent upon the preceding process of production, but is responsible to the succeeding member. Hence, between each person engaged in the distribution of goods, conflicts may arise which involve greater or smaller risks, in case there is a failure to adhere to the appointed period of delivery.

One of the important functions of a middleman is to attend to the fulfilment of contracts with regard to delivery, and especially in the case of goods for exportation. Where the services of a middleman have been used for this purpose, his elimination will mean the assumption of greater responsibility by the person who intends to trade more direct ; that is, the direct buyer or seller will have to undertake greater risks in connection with the delivery of the goods.

QUALITY RISKS.—The practical merchant is well acquainted with the numerous claims, deductions, lawsuits, etc., which arise out of complaints concerning the delivery of goods. In the same way, the trader who has to sell goods as they are received from the manufacturer or other creditor is well aware of his responsibility to deliver in conformity to sample or to quality previously agreed upon. The avoidance of disputes with his customers in this respect is often one of the most difficult duties of the trader, especially where unscrupulous persons are concerned. Such persons may even invent grounds for complaint in order that they can refuse to honour the contract, whenever the market conditions change to their disadvantage.

Under these circumstances, one of the most important duties of the trader is the checking of the goods purchased and a still more careful checking of the goods dispatched, and for this work a thorough knowledge of the commodities themselves is indispensable. It is chiefly for this reason that it is difficult to eliminate a person from the trade organisation who has hitherto

performed this work, and direct buying and selling encounters great difficulties in view of the existence of these quality risks.

On the other hand, there are some cases in which the trader, manufacturer, or consumer endeavours to organise the most direct purchase possible, so that the work of selection can be personally undertaken at the place of production, or because a greater influence may be exercised over the producers in causing them to deliver the goods in conformity with particular requirements. This is seen in such goods as watches, embroidery, and various kinds of machinery. Hence, the risks in connection with quality may operate not only as a hindrance to elimination, but also as a factor assisting it.

MARKET RISKS.—As far as the price is entailed, market risks have already been discussed; but there are other factors to be taken into consideration by the trader. In the first place, he must endeavour to analyse the various symptoms of the rise and fall in the market, and to modify his business accordingly; to provide himself with a stock in good time for a rise in the market price; and to abstain from buying during a period of depressed trade. These tendencies will be the more quickly and correctly grasped, the closer the trader keeps in touch with production and consumption, rather than being separated from them by various middlemen. Moreover, these indirect sources of information are often unreliable, and it should be the trader's aim to keep secret his knowledge of market forces and his arrangements in connection therewith. In this case, the most direct trading relations are preferable (i.e. direct purchase and sale).

There is another factor to be considered—the sudden rise or fall of the market. This operates the more slowly with the increase of middlemen in the process of distribution. Each member engaged in trade offers a certain amount of resistance to sudden alterations in market conditions, since it is to his interest to maintain a steady course of business. Hence, middlemen help to stem any sudden changes from high to low prices and to increase the steadiness of the market. Whether this retarding influence on the market fluctuations is an advantage is very questionable.

Thus, the carrying on of any business is inevitably accompanied by risks; risks very numerous, of a diverse nature, and varying in importance. These risks may be guarded against in many cases

by insurance with a company which makes insurance its business, or by forward contracts. But insurance is expensive, and this factor of expense precludes the covering of all risks, otherwise it would only be necessary for every business to insure its profits. Since it is impossible to cover all risks, the best course is to cover those risks of loss which the business could not afford to meet, whilst not unduly diminishing profits by too heavy insurance premiums.

The study of the risks of trade and their distribution over the members engaged in trade has brought the student a step nearer the principal problem, viz. whether direct trade is to be preferred to indirect, and whether the increase or the diminution in the number of middlemen is desirable.

TEST PAPER

1. Enumerate some of the chief risks in connection with trade.
2. "The trader who buys and sells direct, without the aid of a middleman, undertakes a greater risk in connection with price fluctuations." Explain and criticise this statement.
3. Explain how "Credit" risks arise.
4. Why do risks occur in connection with the payment of debts to traders resident in a foreign country?
5. Upon which members of the trading organisation do those risks fall which are connected with the delivery of the goods?
6. In what respect do middlemen help to increase the steadiness of the market?
7. The trader, it is said, has to carry certain risks. Explain the principal risks he has to carry, and the manner in which he is rewarded for carrying them.
8. The wholesaler is an intermediary between the manufacturer and the retailer. Describe the ways in which he renders services to them, and indicate any special business risks which he shoulders.

CHAPTER XXVIII

ORGANISATION OF THE IMPORT TRADE

THE significance of the import trade is due to the fact that the population of Great Britain is to a large and increasing extent dependent for its food and the materials of its industry on supplies from abroad. In 1958 our food imports were valued at £1,506 million and our imports of basic materials at £908 million. About two-thirds of our supply of wheat and flour and five-sixths of our supply of meat come from abroad. Coal is the only raw material in which Great Britain is almost self-supporting. The whole of the cotton, nine-tenths of the wool and timber, and more than a third of the iron ore which we use are imported from overseas. During the last century there has been a steady growth in our dependence on overseas supplies for the essential means of existence.

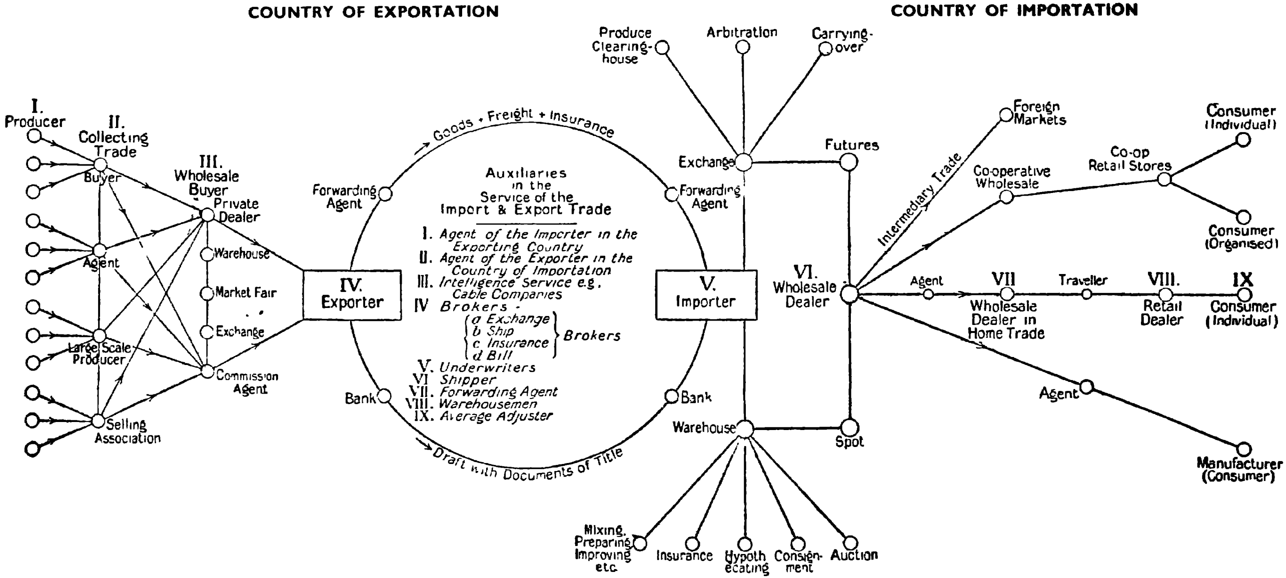
GENERAL ORGANISATION OF IMPORT TRADE.—The diagram on page 272 will serve to illustrate the general organisation of the import trade. In order that the student may obtain a firm grasp of the relationship existing between the producer and the consumer, all the main functions of trade have been included. Of course, all these functions will not come into play in every transaction, but there will be a variety of combinations according to circumstances.

An examination will first be made of those trading functions proper which are marked in Roman figures on the diagram, each of which appears as buyer and seller of the goods during their distribution to the consumer, and through whose hands the goods pass as property.

No. 1 represents the *supplier* of goods in the country of exportation, and No. IX the English *consumer*. Since they both play a passive part in the trade itself, they may be left out of consideration. Hence, in analysing the diagram, it only remains for the student to consider the seven traders proper (marked Nos. II to VIII). Nos. II and III are engaged in the *Collecting Trade*, whilst Nos. VII and VIII are concerned with the *Distributing Trade*. Nos. IV to VI represent the trade conducted by *Intermediaries* in the centralised market.

COLLECTING TRADE.—The first class of traders through whose

STRUCTURE OF THE IMPORT AND EXPORT TRADE



hands the commodity usually passes on leaving the supplier or producer is that of the collecting trader. The main object of this branch of trade lies in the purchase of large or small quantities of goods, their receipt, supervision, assortment into various qualities, preparation for transport, and the transference of the goods to a larger warehouse to enable them to be handed over to the wholesale dealer. The functions of the collecting trade, like that of the distributing trade, are undertaken by two members—the small collector and the large collector. The first of these comes into direct communication with the primary producer, and must not only be able to judge the conditions of the market, but also possess a good knowledge of the goods themselves. He must be in constant touch with both small- and large-scale producers, and know their methods of trade, the extent of their output, their financial standing, as well as enjoy their confidence. Of course, this is possible only where the collecting trader acts in good faith and keeps to his word, carrying out punctually his promises and obligations in reference to acceptance of the goods, payment, etc. This first function of collecting, as shown on the diagram under No. II, may be effected by—

(*a*) A private buyer working on his own account.

(*b*) An agent, who is engaged in effecting the purchases for the wholesale firm;

(*c*) A large-scale producer, who combines the function of collecting with that of production;

(*d*) An association of producers, who form a selling association, or cartel, the latter undertaking the collection of goods from the producers.

Whichever of the above methods of collection be adopted, the buying area is naturally restricted to a definite locality.

A much larger purchasing area comes within the sphere of the wholesale collector, who is marked No. III on the diagram. To him the various small collecting traders deliver their products, or he may send his numerous agents into the purchasing area.

The wholesale collecting may be effected either by—

(*a*) A dealer trading on his own account;

(*b*) A commission agent.

Both these traders may utilise the services of the warehouse, market, fair or exchange, prior to the disposal of the goods to the exporter.

INTERMEDIARY TRADE.—The members of the intermediary trade are marked on the diagram Nos. IV, V, and VI, and consist of—

(*a*) The exporter in the country of origin, who draws his supplies from the wholesale collecting trade;

(*b*) The importer in England;

(*c*) The wholesale dealer engaged in the import trade.

These traders not only have extensive capital at their disposal, but have also far-reaching trading connections with all the important points of the world market. They engage in the import and export trade without being tied to fixed relationships. On the other hand, however, they so utilise market conditions, that they are able to bring their goods to certain central points, from which they can then easily be conveyed to the most favourable selling areas at home or abroad. The place of business of an intermediary may be anywhere, since, on account of the well organised system of communications and widespread means of warehousing, it is easy for him to dispose of his goods from any point. However, his head office is usually to be found in one of the great trading and warehousing centres of the world.

When the goods have been sold by the exporter in the country of origin to the English importer, there are three distinct classes of operations performed by the English intermediaries engaged upon the produce exchange—

(1) The importation of consignments of goods by the import merchant;

(2) Sale by auction of the goods in lots by the brokers acting for the importer;

(3) Purchase by the wholesale dealer from the broker in large quantities.

It will be seen from the diagram that the last member of the intermediary trade, viz., the wholesale dealer engaged in the import trade, and marked No. VI, may dispose of his goods in a variety of ways—

(1) He may tranship a portion of his goods to foreign markets;

(2) Another portion may be sold through his agents to home manufacturers, as in the case of such goods as tobacco, etc.;

(3) Another portion may be sold to the wholesale dealer in the home market; and

(4) He may supply the Co-operative Wholesale Society, which, in turn, will distribute the goods through the retail societies. These may further dispose of the goods to their own organised members, or to individual consumers who are non-members.

DISTRIBUTING TRADE.—The members of the distributing trade are marked Nos. VII and VIII on the diagram. In this class of traders is included, not only the retail dealer, but also the wholesale dealer engaged in the home market, whose object it is to supply the retail dealers within his selling area with the commodities they require. The wholesale dealer No. VII, who is engaged in the home market, has quite a different function to perform from the wholesale dealer No. VI. Whilst the latter is engaged as an intermediary in the world market, and occupies himself with the purchase and sale of a single commodity (such as coffee, corn, tobacco, etc.), No. VII is a distributing trader engaged in the purchase and sale of a variety of different commodities. Again, wholesale dealer No. VI supplies a large area with a single article only, whilst No. VII supplies a smaller selling area with the various goods in his line of trade. Thus he may deal in coffee, tea, sugar, and provisions generally.

The last link in the distributive trade is occupied by the retail dealer No. VIII, to whom is allocated the task of holding an available stock of goods to meet the requirements and wishes of his customers, and to sell these goods in small quantities to the individual consumers.

From what has been already said, it will be seen that a commodity passing in the regular way through the hands of all the members engaged in the import trade (marked I to IX), changes hands no fewer than eight times. It is eight times the subject of a purchase and sale, regardless of the possibility of its repeatedly becoming a factor on the speculative exchanges as either a floating or warehoused commodity. Since each trader adds to the price the threefold increase of trading expenses, wages, and profit, it is clear that the entire organisation diminishes the price of the goods to the producer and increases them to the consumer. It is, therefore, the aim not only of the producer and consumer, but of every middleman, to simplify the method of distribution by the elimination of all unnecessary members.

THE IMPORTATION OF TEA.—Supplies of tea reach us from India, Ceylon, Java, Sumatra, Africa and China. The northern Indian crop is far the heaviest of any country of production. The plucking and collection of this Indian crop begin early in April and continue till about the middle of December. The great bulk of the tea is imported here by the companies which grow it. There are many varieties of tea, the grades of which vary in quality and character to a very great extent. Of the various grades some are specially suitable for re-export, and others for different areas of the United Kingdom according to the varying tastes of consumers in this country and the qualities of local water supplies.

The tea, after manufacture on the estate, is packed into chests which are dispatched by the garden managers to the local port, where managing agents arrange for shipment to London. The Port of London Authority has many bonded warehouses specially for tea, and there are a number of others in London belonging to independent firms. On arrival of the consignment it is at once discharged from the steamer and transported to one of these warehouses, where it is weighed by the Customs officials and stored until the tea is sold and released for payment of duty. The agent of the tea estate receives weight notes and certificates, and when he has decided on the most favourable time to sell, he gives instructions to his broker to include the parcel in the public sales in Mincing Lane. At the same time he notifies the bonded warehouse so that the representative chests of each grade may be put out conveniently for sampling.

The centre of the world's tea trade is in London, about two-thirds of the total trade of the world being done with the United Kingdom market. Auctions of tea are held at the Commodity Exchange in Mincing Lane, and take place throughout the year on four days of the week, Mondays to Thursdays. The selling broker, who is entrusted with the disposal of the tea, compiles a weekly catalogue, in which the teas for sale are divided into convenient lots. To each of these a number is given, the name of the estate where the tea was grown, the quantity and description, the name of the warehouse where it is stored, and also the number of the tin in the broker's office in which is contained a sample of the particular parcel. Each catalogue also sets out in detail the conditions of sale, the date and time of the sale, and the "prompt" date. This latter is three months

from the date of sale and is the latest date on which the buyer must make payment; in the meantime, the sellers are responsible for all storage charges, and should delivery be taken before the prompt date interest is allowed for the unexpired period.

These catalogues are issued to all the largest buyers and wholesale tea merchants, who send one of their assistants to the warehouses named to obtain a sample of the teas in which they are interested. The next step is for the prospective buyer to have the teas tasted by experts in order to estimate their values for his purposes, which are generally for blending. Most wholesale merchants run several qualities of tea, which it is necessary to keep up to a uniform standard. This cannot be done by always using teas from the same estate and in the same proportions, for the production of each estate varies during different parts of the year. It is therefore necessary to judge by tasting which teas, as they come on the market, will produce the requisite blend.

The immediate purchasers of most of the tea auctioned in Mincing Lane are the buying brokers. They number about a dozen and are members of the Tea Buying Brokers' Association of London. These act on behalf of the blenders and wholesalers at a commission of ½ per cent. The procedure at the sales is the same as that adopted at auctions generally, the bids are so much per pound, and the advances are by farthings. At the end of the sale the buyer applies to the selling broker for an order authorising him to draw at the bonded warehouse samples of the tea he has bought. These are compared with the original sample and, if inferior, the buyer can repudiate the sale. If, however, everything is in order, the selling broker sends out his advice note of the sales to the buyer and to the owner of the teas sold. These are now at the disposal of the buyer to take delivery any time within three months, and warrants are issued in return for payment as deliveries are required.

The tea is now in the hands of the wholesale merchant or the blender, who proceeds to prepare it for distribution. The tea is blended on a large scale and is distributed to the retailer either loose or, more frequently, in packets. The blender may also be part of a multiple shop organisation distributing the tea either through its own chain of retail shops, or through other shops as well. The great bulk of the tea thus distributed is sold in packets as a proprietary article.

TEST PAPER

1. Copy the diagram on page 272 and explain the functions performed by the members marked in large Roman figures.

2. Classify the various members shown on the diagram on page 272 as Collecting, Intermediary, and Distributing Traders.

3. Explain the function of the Collecting Trade, and name the persons who take part therein.

4. Indicate clearly the relation between the Intermediary Trader and the Centralised Market.

5. State three distinct classes of operations conducted by intermediaries engaged upon the produce exchange.

6. Enumerate the various channels open to the wholesale dealer engaged in the Import Trade for the disposal of his goods.

7. What is the function of the Distributing Trade?

8. Point out the chief differences in the services rendered by No. VI as compared with No. VII in the diagram on page 272.

9. Name the members engaged in the Distributing Trade, and describe the nature of the services rendered by each.

10. Show clearly how an imported commodity may change hands at least eight times before reaching the consumer.

11. Imported foodstuffs are largely sold by auction, whereas raw materials such as cotton are offered for sale in organised markets. Select a typical commodity sold in each of these ways, and explain how it eventually reaches the consumer.

12. Choose any imported commodity sold at a London produce exchange and trace the course it takes from its entry into an English port to its receipt by a consumer.

CHAPTER XXIX

Transactions in the Import Trade

As a rule, the shipping department of a mercantile establishment of any magnitude is a distinct branch, having its own manager. On their receipt by the office, all Bills of Lading for imported goods to arrive would be sent to this department, where they would be dealt with by the shipping clerk.

The first step to be taken on receipt of the Bill of Lading is to ascertain when the vessel carrying the goods named on it is likely to arrive. On the vessel's arrival the goods are landed and taken charge of on behalf of the importer by one of the dock companies or wharfingers, and the consignment is directed to one of the warehouses used for storing that class of commodity. These dock companies undertake the duty of weighing, measuring, gauging, sampling, etc., in accordance with the requirements of the various trades, for which purpose a large staff of experts and specialists is maintained. The preparation of the goods for sale having been completed with as much dispatch as possible, various accounts, known as "Landing Accounts," "Weight Accounts," "Piling Accounts," etc., are furnished to the importer, and samples are at the same time sent either to him or to some person authorised to receive them on his behalf.

If the goods are not liable to Customs duty on importation, they are left at the disposal of the importer, after the examination by the Customs House officers has been made. On the other hand, if the goods are dutiable, all stages in their importation are jealously watched and guarded. The weighing is done in the presence, and under the actual direction and superintendence of an officer of Customs, and, in the case of tobacco, the actual manipulation of the weights is done by a subordinate official. The contents of the casks containing wines and spirits are measured by an official gauger. The weights and measures so taken are then recorded by the Customs officers, and these records become the official accounts of the goods, from which are compiled the returns made to the merchants, as named above.

The Landing Accounts having been received, the next step is

to make arrangements for the sale of the goods, which is almost invariably done through the agency of a broker. Various classes of produce have their special markets, each of which forms the centre round which the brokers congregate when dealing in that particular class of goods.

At the Commodity Exchange in Mincing Lane, sales are held daily of all sorts of Colonial and East Indian produce: teas, coffee, cocoa, sugar, spices, drugs, indigo, ivory, rum, jute, saltpetre, silk, and the numerous minor products of India and the East.

Again, the Corn Exchange, in Mark Lane, is devoted to the sale of cereals and agricultural seeds mainly home grown; whilst the Baltic, in St. Mary Axe, is devoted to the sale of foreign grains, oil seeds and of the manufactured products of these seeds, such as oils and oilcakes. (It is also the market for shipping and aircraft cargo space.) The sales of wool are held at the Wool Exchange, in Coleman Street, where they take place at regular intervals. Green fruits are sold at Pudding Lane and Monument Yard, where the City fruit brokers have their sale rooms and offices. Covent Garden is also a large centre for the sale of this class of produce.

The samples drawn by the wharfingers are dispatched to the sale rooms of the brokers in these various localities. Here, they are inspected by the numerous buyers who frequent this special market.

The sales are usually by auction, the brokers taking care so to arrange their sales that one does not clash with another. At these auction sales, produce of fabulous value is bought and sold with a rapidity almost incredible to the uninitiated.

Having effected the sale of the goods placed with them, the brokers now send to their principals a **Contract Note,** setting forth all particulars of the goods sold, together with the price obtained for them; the terms on which they have been sold, and the date when the purchase is to be completed by the buyer paying for his purchase and receiving in return the necessary documents to enable him to obtain possession of the goods.

In the meantime, the importer has taken the necessary steps to obtain the "*Warrant*" for the goods housed with the Dock Company or other warehouse proprietor. This Warrant is a document of special value, since it represents the goods named on it, and, being transferable by endorsement, it is a simple and effectual method of completing a sale by handing it to the

purchaser, as being equivalent to the articles he has purchased. When once a Warrant has been issued for goods, no delivery can be made from the warehouse where they are lying unless the Warrant, duly signed, is produced.

The Warrant is endorsed and passed to the purchaser of the goods. The brokers remit the proceeds, together with *Pro Forma* Account Sales, showing all the necessary particulars of the merchandise sold, with the price obtained and the amount realised. From this latter amount they will have deducted any expenses incurred or paid on the goods and their charge for selling (i.e. "Brokerage").

On receipt of the brokers' Account Sales, the first duty of the importers is to subject it to critical examination. The weights are compared with the landing accounts, and the prices with the contract notes, and the various calculations are carefully checked to see that no errors have crept in or passed unnoticed in the brokers' office. The next duty is to prepare from the brokers' account an Account Sales, to be furnished by the importers to the original and actual proprietors of the goods, the exporters from the place of origin. This will be a transcript of the brokers' Account Sales, but, inasmuch as the home merchants will have paid a variety of charges and expenses upon the goods in the shape of Freight, Dock Charges, Marine and Fire Insurance, they will add these items to the charges made by the brokers, and, after adding their own commission, will deduct this increased amount of charges from the gross proceeds of the sale, and will show the final amount of "net" proceeds which is to be credited to their correspondents.

CHAPTER XXX

CUSTOMS AND EXCISE

THE CUSTOMS SERVICE.—The primary business of this Government activity is the collection and management of duties of Customs and Excise in the United Kingdom of Great Britain and Northern Ireland.

The service is controlled from the Custom House in London, where the offices of the Commissioners of Customs and Excise are situated. For purposes of administration, the coast of the United Kingdom is divided into areas, which are each in charge of a Collector, who is responsible for the Customs work therein. Most of these areas contain a head port and, in addition, subsidiary ports and creeks. These subsidiary ports and creeks are in the charge of officers of lower rank, subject to the Collector's supervision.

For convenience the Customs administration is divided into three main branches—

(1) The Waterguard (or Preventive) Branch.

(2) The Landing, Shipping, and Warehousing Branch.

(3) The Clerical Branch.

The primary duty of the *Waterguard Branch* is the detection and prevention of unauthorised landings of uncustomed or prohibited goods by crews and passengers. The officers take account of the arrivals and sailings of vessels; meet and board vessels; take any necessary steps for the safety of the public health; deal with the dutiable stores of the crew and the vessel; and examine the personal effects of the crew and the baggage of passengers, and in most cases assess and receive any duty chargeable thereon. They visit and search vessels while in harbour, and watch shipping generally, with a view to the prevention of smuggling.

The work of the *Landing, Shipping, and Warehousing Branch* is mainly connected with goods which are (*a*) imported, (*b*) deposited in bonded warehouses, or (*c*) exported: The duty of the officers in connection with imported merchandise is to satisfy themselves that all goods borne on the "report" made by the Master of the importing ship are satisfactorily accounted for, and that all goods landed are duly "entered" in the appropriate form by the importer. The officers exercise control over the receipts and deliveries of goods at bonded

warehouses and supervise operations on goods while in bond. They also examine goods from bonded premises presented for shipment.

The officers of the *Clerical Branch* deal with the receipt and payment of moneys and perform indoor clerical work. They receive and register the "reports" of masters of vessels arriving and issue "clearance" documents to masters of vessels departing.

CUSTOMS.—These are taxes imposed upon a commodity as it passes the frontier inwards or outwards. If the tax is imposed as the commodity enters the country it is an *import duty;* if it is taxed as it leaves the country it is an *export duty*. These taxes are among the oldest in history. Investigations have shown that among the earliest civilisations, such as the Babylonian, there were cases of Customs duties.

The law requires that all persons concerned in bringing over to this country foreign goods of any description shall furnish definite information with regard to the same before the goods are landed. This information is of a twofold character, viz. the Ship's Report, and the making of the necessary entries.

SHIP'S REPORT.—The Master of every ship trading between a foreign port and this country is required to deliver a report, within twenty-four hours of arrival, of the whole of the cargo of his ship. Until this requirement is complied with, bulk is not to be broken, and no goods are to be landed. The chief points with regard to the Ship's Report are—

(1) The Report to be made on the prescribed form.

(2) Particulars are to be furnished as follows: Name of ship, port of registry, nationality, master, port whence, number of crew, number of passengers (if any), whether British or alien.

(3) Particulars of the whole of the cargo set out in detail, such as—

Marks.	*Nos.*	*Description of Goods.*	*Landed or Transhipped.*
V5	365/400	36 Casks Wine.	Order or In transit, as the case may be.

(4) When a vessel intends to discharge at several ports in the British Isles, a separate report is to be furnished relative to the goods to be landed at each port. Only goods thus *reported* can be landed at any particular port.

(5) The master is required to furnish an account of all stores

This space is for the use of the officers of Customs.

ENTRY FOR FREE GOODS

Collector's No. and Date

Collector.
Customs and Excise

Port of London

Dock or Station, Britannia Wharf

Importer's Name C. Wray & Co.

Examination.

Ship's Name.	Master's Name	Rotation No.	Date of Report.	Port or Place of Shipment of Goods.
Alan	A. Brown	36	2/1/.	Rotterdam

Marks and Nos.	No. of Packages and Description of Goods in accordance with the Official Import List.	Quantity.	Value * £	Name of place whence goods consigned.
X C.M.W.	One hundred Casks Zinc Oxide Painters' Colours	cwts. 200	215	Holland

I enter the above Goods as free of Duty, and declare the above particulars to be true.

Dated this 2nd day of January 19 .

(Signed) C. Wray & Co.
Importer or his Agent.

* (1) In the case of goods which are invoiced at a quoted price, the value to be stated in the Customs Entry should be the prime cost with the freight and insurance added ("c i f" value).

(2) When the goods are consigned for sale, the value to be given should be the latest sale value of such goods.

liable to duty in the possession of himself or of his crew. Goods not duly reported are liable to detention and seizure (to be converted to the Queen's use) unless satisfactory evidence is forthcoming to prove that no fraud was intended. If the report is found to be false, the master is liable to a penalty.

ENTRIES.—The importer, who may be the owner of the goods, or his accredited agent, is required, before his goods are landed, to declare and describe them in a document called *an entry.*

This description is to be in accordance with the requirements of the Import Tariff List.

(1) The entry is passed by the officers of Customs at the port of importation, and must agree with the record of the goods as contained in the report.

(2) Upon the production of this entry, the goods are allowed to be landed.

All goods are allowed to be landed except those prohibited by law to be imported. They must be entered and landed within twenty-one days from the date of the arrival of the ship, and are on no account to be removed, or in any way interfered with, prior to the Customs examination.

CLASSIFICATION OF GOODS.—The stage has now been reached when the goods have been removed from the ship and are awaiting examination and delivery. The subsequent procedure depends upon the nature of the goods. They may be classified broadly into two main groups, viz. Free Goods and Dutiable Goods.

Procedure with Free Goods. With free goods, the subsequent procedure is comparatively simple, and is as follows—

(1) The entry, known in this case as a "Free Entry," or "**Entry for Free Goods,**" is produced to the Customs officer where the ship is discharging. This entry should be made out in triplicate, and becomes the property of the Crown. The specimen on page 284 should be carefully studied.

(2) The goods are examined, and if the result of the examination coincides with the particulars as set forth on the entry, the goods are passed as satisfactory.

(3) When the Customs authorities are satisfied that the requirements of the law have been duly observed, delivery of the goods is allowed.

No account of any goods can be taken by the Customs after the

ENTRY FOR HOME USE EX-SHIP

Port of Importation London *Dock or Station* Britannia Wharf

Name and address of Merchant paying the Duty Arthur Riggs & Sons

(If Post) Prime Entry No. ________ dated ________ 19

Ship's Name	Date of Report	Master's Name	Port or place of Shipment of Goods
Commodore	3/3/	Hy Maitland	Rotterdam

Marks and Numbers	Place and Country of destination in United Kingdom for Unmanufactured Tobacco and Spirits only	Number of Packages and Quantity in Words and Description of Goods in accordance with the Official Import List	Name of place whence Goods consigned	Quantity in Figures	*Value	£	s.	d.
A.R 1/5		Five Casks Still Hock Wine ne 30° Three hundred and fourteen Gallons	Holland	314	£63	19	18	3

Total amount of Duty payable on this Entry . ... . £ 19 18 3

I declare the above particulars to be true.

Date 4th March 19 (Signed) C Thompson

~~Importer or his~~ Agent.

Collector's No. and Date

*(1) In the case of goods which are invoiced at a quoted price, the value to be stated in the Customs Entry should be the prime cost with the freight and insurance added ("c i f" value)
(2) When the goods are consigned for sale, the value to be given should be the latest sale value of such goods.

goods have passed from their charge, nor are the officers responsible for any damage to goods during examination. (Customs Consolidation Act, Sect. 76.)

Procedure with Dutiable Goods. With dutiable goods, the procedure is more complicated. The importer can choose from two courses which are open to him. He may either elect to pay duty *immediately on importation*, or elect to *warehouse the goods* in duly approved warehouses.

Procedure when the Importer desires to pay Duty at once. If the importer elects to pay duty on his goods, the following procedure must be observed—

(1) An entry must be passed giving the full description of the goods as to value, weight, and duty chargeable. This is known as an "**Entry for Home Use *ex* Ship.**" (See specimen, page 286.) It is passed by the Customs at the port of importation and the duty is paid at the time of passing.

(2) This entry, when duly passed and stamped to the effect that the duty has been paid, is forwarded to the officer at the dock or wharf where the goods are lying.

(3) The goods are examined. If the result of the examination agrees with the particulars on the entry, the goods are released. Should the weight of the goods, and, consequently, the duty chargeable, be found to exceed that declared in the entry, the additional duty must be paid before the goods can be delivered. If the reverse is the case, the excess duty is refunded to the merchant.

When the goods are liable to a differential duty, varying according to strength, as in the case of wines and spirits ; polarisation, as in the case of sugar ; degree of sweetness, as in case of preserved fruits and condensed milk, *samples* are forwarded to the Government Laboratory in order to ensure that duty is paid on the correct tariff rating.

Procedure when the Goods are to be Warehoused. On the assumption that the importer chooses the alternative described above, and elects to warehouse his goods, the procedure is as follows—

(1) A "**Warehousing Entry**" is passed at the Custom House. At the same time, a **Landing Order** relative to the goods is passed. The former is forwarded to the warehouse; the latter to the dock or wharf where the goods are lying.

(2) Upon the receipt of the Landing Order, the officer at the dock allows delivery of the goods. They must be secured in a locked van with a Crown lock, or be accompanied by a Customs watcher (all at the merchant's expense).

(3) Upon being received at the warehouse, they are examined by the officer in charge and the account is taken. This being accomplished, the goods are legally warehoused, and the warehouse keeper is held responsible for their safe keeping.

DELIVERY FROM WAREHOUSE. When delivery of goods from the warehouse, either for home consumption or for exportation, is required, the procedure is for the merchant to prepare a "**Warrant**" (see specimen on pages 289–290). If the goods are for home consumption, this document will be composed of three parts—

(1) First portion will furnish particulars of goods. These will be checked by the Customs.

(2) Second portion will be a memorandum as to duty chargeable.

(3) Third portion will be a **Delivery Order** to the warehouse keeper.

If the particulars are correct, and when the duty is paid, the third portion (the Delivery Order) is forwarded to the warehouse, and the officer in charge allows the goods to be delivered.

When the goods are for exportation, the procedure is slightly different. A "**Warrant**" is passed as before, but the merchant has also to pass a "**Shipping Bill.**" This document furnishes particulars of the goods (marks and numbers), the name of the export ship, and where she is lying.

(1) The "Warrant" is composed of two portions only, there being no duty chargeable in this case. The first portion is retained by the Customs and the Delivery Order is forwarded to the warehouse.

(2) The "Shipping Bill" is forwarded to the officer at the dock where the export ship is lying.

(3) Bond is required in all cases of exportation of dutiable goods, to cover the amount of the duty.

(4) When the officer furnishes a certificate of shipment on the Shipping Bill, the Bond is thereby cancelled. (A specimen "Shipping Bill" is shown on page 291.)

TREATMENT OF GOODS WHOSE EXACT DESCRIPTION IS UNKNOWN. —The law subjects importers and their agents to severe penalties for

Ledger No ______ Folio ______

I. WARRANT—WET GOODS FOR HOME CONSUMPTION.

Port or Collection London
Station Surrey Dock
Number ______
Month and Year October 19

Collector's No. ______
Collector's Date ______

To the Officer in charge of Surrey Dock

Notice is hereby given to deliver the undermentioned*

Signature of Proprietor or his Agent H Phillips & Sons
Address 16 Gale St EC
Date 13th October 19

*Number and description of Packages and Goods to be stated. Five Casks of Olives Line nc 30°

Landing or Warehouse Account (to be filled in by the Merchant): Bonder's Name, Rotation, Date	Marks and Numbers	Content	Ullage	Obscuration	Actual Strength	Proof Gallons	Register and Folio	Difference + or − when warehoused or measured ullage	Number of samples taken since last warehoused	Re-examination: Wing. Calc. pars. still — Bung	Wet	Ullage	Hydrometer Strength	Actual Strength	Proof Gallons	Deficiencies: Allowed	Charged	Warrant Book and Folio
H Phillips & Sons	P S 1	47	46						—									
	— 2	48	47						—									
1914	— 3	48	46						2									
3917	— 4	47	46						—									
	5	46	45						—									
			230															

Name of Firm paying duty H Phillips & Sons

	£	s.	d.
Duty at 1/9 per gall.	20	2	6
Bottling charges	—	—	—
Total	20	2	6

______ Officer
______ Date.

Received the sum of Twenty pounds, two shillings and six pence.

Collector of Customs and Excise.

II. MEMORANDUM TO BE RETAINED BY COLLECTOR.

Collector's { No. ______ Date ______

Station Surrey Dock

Paid by H Phillips & Sons

Description of Goods Wine

	£	s.	d.
Duty	20	2	6
Bottling charges . ..	-	-	-
Total	20	2	6

C. and E. No. 495.

Warehousing Code, paras. 496—505.

Sec. $\frac{20332}{1914}$.

NOTE.—If the duty is paid on Gross Payment Receipt this Memorandum is not required and should be detached.

III. WAREHOUSEKEEPER'S ORDER.

Station Number ______

Month and Year October 19[illegible]

To the Warehousekeeper at Surrey Dock

You may deliver the undermentioned goods, provided that they are actually removed from the Warehouse before any addition has been made to the duty chargeable.

Number and description of Packages and Goods in words	Bonder's Name	Rotation and Year	Marks	Numbers	Date of delivery (to be filled in by the Warehousekeeper)
Five Casks Claret Wine re 30°	H Phillips & Sons	1914 3917	P&S	1/5	

H Phillips & Sons } Name of Firm paying Duty.

______ Officer of Customs and Excise.

______ Date.

* Erase the words that do not apply

SHIPPING BILL FOR ~~DRY~~ WET GOODS AS MERCHANDISE.

Under Bond

Port or Collection London
District
Station Surrey Dock

Station No.
Month and Year August 191

Export Ship Paragon Master Henry Fraser for Stockholm

Entered Outwards 4th August 19   Bond given 2nd August 19

Station ____________   Lighterman Dugden

Conveyance Lighter   ~~Carman~~ ____________

H Rendall ~~Exporters or~~ Agents

19 St James St. E.C. Address

Shipping Marks and Numbers, Final Destination and name and address of the Consignee	Number of Packages	Description of Packages	Description of Goods	Quantity: Wet Goods, Gallons, &c.	Quantity: Dry Goods, cwts.	qrs.	lbs.	Country whence goods were consigned when imported	Rate of Drawback (if any) claimed	Value
			N B.—These goods must be produced to the Officer of Customs and Excise at time of Shipment, and any Short-Shipment notified.							
F D 1/5	Five	Cases	Burgundy Wine ne 30°	Nine gallons				France		£17
TOTAL										

Name & Address of Consignor: Hy Philips & Sons, 16 Gale St, London E.C.

____________ Officer.
____________ Date

I declare that all the particulars set forth above are correctly stated and that the person for whom the goods to which this Shipping Bill relates are ultimately destined is not a person who is an enemy or treated as an enemy under any law for the time being in force relating to trading with the enemy* ~~I further declare that the goods are of British Manufacture, and claim Drawback on~~

*Strike out words in italics if not required

H Rendall ~~Exporter~~ or Agent

Port ____________

Date ____________ 19

Received the above-mentioned packages on board this ship ____________ Master, Mate, or authorised person.

____________ Countersignature of Officer of Customs and Excise

Particulars of Examination and Certificate of Shipment to be inserted here

Export Officer.

N B.—The Lightermen or Carmen are particularly required to give immediate notice to the Export Officer if any of the above mentioned Goods be shut out of the Vessel, and on no account to take them to any other Ship than the one above named without his permission.

false declarations as to the nature of the goods they import. It often happens, however, that the importer is not in possession of sufficient information to warrant his making an exact description of his goods for examination purposes. To meet this case, he may pass a document known as a "**Bill of Sight.**"

This document gives all the information in the possession of the importer, and a declaration to the effect that such information is not sufficient to justify him in definitely entering the goods as dutiable or non-dutiable, as the case may be.

The Bill of Sight is forwarded to the officer at the dock or wharf where the goods are lying. The goods are thereupon examined, and the subsequent procedure depends upon the result of this examination.

(1) If the goods are not liable to duty, the Bill of Sight is perfected into a "Free Entry," and the goods are delivered.

(2) If the goods are liable to duty, the Bill of Sight is perfected to a "Prime Entry," and the duty paid. Delivery is then allowed.

Goods treated in this fashion usually include such articles as: tins of fancy biscuits, preserves of various fruits, scented waters, packages of books, clothing with other goods liable to duty, etc.; special preparations of medicines, paints, etc.

GENERAL NOTES ON IMPORTATION.—With regard to the administration of the Customs, the following points are of general interest—

(1) The Customs officials act as Public Health Authorities relative to the importation of various kinds of foods. All tea must be approved before it is admissible for consumption.

(2) The Merchandise Marks Act, administered by the Customs, provides against the fraudulent use of registered trade marks with a view to deceiving the consumers. Goods must be plainly and indelibly marked with the country of origin, such as "Made in Germany," or with some other mark which leaves no doubt as to the country of origin.

(3) The importation of various articles is prohibited, e.g. obscene literature, lottery tickets, coin, matches with white phosphorus, gooseberry and currant bushes, hay, goods which have been made in prisons abroad.

(4) Various restrictions govern the importation of other goods—explosives, live animals, etc.

(5) Goods can be landed only at places approved for the purpose. The list of approved docks, wharves, etc., is very large for London.

(6) Practically all tobacco, wines and spirits imported into the Port of London are warehoused. The proportion upon which duty is paid immediately on landing is exceedingly small.

IMPORT DUTIES ADVISORY COMMITTEE.—This is a Committee constituted for the purpose of giving advice and assistance in connection with the discharge by the Treasury of their functions under the Import Duties Act, 1932, which provides for the imposition of Customs duties on imported goods.

Excise

EXCISE.—This word has been narrowed in its meaning in modern times. Formerly it had reference to any kind of tax upon any description of commodity, but now it is applied chiefly to a tax upon the production of an article within the country. Excise duty was first imposed about 1643 by the Long Parliament. It postulates production for a market and is imposed upon certain commodities which are produced in large quantities. Again, an Excise duty must be imposed to counterbalance the import duty on the same kind of goods or there would be a preference given to the home producer equivalent to a protective tax. If a tax be imposed on the importation of spirits and the home manufacturer be exempt, then the home production of spirits would be protected to the amount of the tax and the amount of imports would tend to decline.

Customs and Excise duties together yielded a revenue of over £2,000 million in 1955.

Excise duties may be broadly classified as under—

(1) Duties on Commodities. Beer, Spirits, Wines, Glucose, Saccharin, Matches, etc.

(2) Licence Duties. These duties are generally payable when persons are licensed for the sale of commodities, and are divided into two main divisions—

(*a*) *Liquor Licences.* Distillers, brewers, rectifiers and compounders, wine manufacturers, wine, beer and spirit dealers and retailers (publicans), clubs, etc.

(*b*) *Other than Liquor Licences.* Motor spirit dealers, methylated spirit retailers, tobacco manufacturers and dealers, hawkers, pawnbrokers, vinegar makers, theatres, etc.

COMMODITIES SUBJECT TO EXCISE.—The following are subject to Excise Duties—

DISTILLERIES. One of the principal items of Excise revenue is the duty on British spirits. The spirit is manufactured at the various distilleries under strict Excise supervision at every stage in the manufacture. The spirit, when manufactured, is warehoused at the Distillery Warehouse, and the procedure when delivery is required is similar to that when dealing with Customs Warehouses.

A proportion of the spirit thus produced is used for the manufacture of methylated spirits. The pure spirit is mixed with certain proportions of wood naphtha, if industrial methylated spirit is required, and wood naphtha with mineral naphtha, if the mineralised variety is required. The alcohol thus disposed of is free of duty. The manufacture of methylated spirits is under Excise control.

BREWERIES. The other main item of Excise revenue is the duty on beer. The duty being considerably less than on spirits, the Excise supervision is less rigid as a consequence. The whole process is supervised by the Crown officers at the various breweries.

The duty is paid at the end of every month, and no beer is warehoused in Bonded Warehouses, as is the case with wines and spirits.

GLUCOSE. Various glucose factories exist and are under Excise survey.

BRITISH WINES. There are only a few manufacturers of British wines subject to Excise survey.

SPIRITS. The only commodity which is, in the real sense subject to continued Excise control consists of **British spirits.** All British spirits must be disposed of in one of the following ways—

(*a*) For Home Consumption;
(*b*) Methylation;
(*c*) Exportation.

Home Consumption. In the case of home consumption the procedure is as follows—

(1) The casks, immediately on being filled from the distillery, are warehoused in the distillery warehouses. When all the particulars are taken, the merchant fills up his "*Removal Warrant.*" This document sets forth the contents of the cask and the strength of the spirit.

(2) The casks may be removed to a rectifier or compounder. Only "Duty Paid" spirits are thus allowed to be disposed of.

They cannot be removed from the distillery, even after duty has been paid, until an *Excise Permit* is granted. This document accompanies the goods to their next destination.

(3) The spirits are rectified and compounded (i.e. flavoured, sweetened, etc.). All rectifiers and compounders are subject to Excise supervision. Before the goods can be removed, another Excise Permit is granted, and accompanies the goods as before.

(4) The spirits are now removed to a spirit dealer, who is duly licensed to receive spirits. A spirit dealer is not allowed to sell less than 2 galls. of spirit in any one consignment. An Excise Permit must again accompany the goods.

(5) The spirit dealer now forwards the spirits to the spirit retailer or publican. He is duly licensed, and is not allowed to sell more than 2 galls. in any one consignment. An Excise Permit again accompanies the spirit.

The important point to remember is that all spirits, even when "Duty Paid," must not be removed either from warehouse to dealer, or from dealer to retailer, unless accompanied by an *Excise Certificate*. These persons are liable to be challenged at any time by a Crown officer, and unless this Certificate is produced, the goods are liable to seizure.

Methylation. A proportion of the spirit produced is used in methylation. The spirit is removed to the methylators under Bond and accompanied by a Permit. The spirit is mixed with mineral and wood naphtha in the presence of an Excise officer.

When the methylated spirit is sent out to the dealers or retailers it must be accompanied by a Certificate. These Certificates are inspected every quarter.

Exportation. The procedure is almost identical with that followed by the Customs in dealing with the exportation of goods.

DRAWBACK.—This is the sum paid back by the Government upon certain classes of goods exported on which duty has already been paid. Drawback goods consist chiefly of two classes—

(*a*) Goods manufactured in the United Kingdom on which Excise duties are paid, such as spirits and malt liquors; and

(*b*) Those composed of raw material which has paid Customs duty on importation, such as snuff, manufactured tobacco, and cigars.

Neither Customs nor Excise duties are payable on goods which are not consumed within the United Kingdom, and therefore it is

necessary to make provision for the repayment of duty which has already been paid under either of these heads.

To secure this repayment or drawback, notice must be given to the Revenue officers of the intention to export any such goods, which are then placed in charge of the Customs officers in attendance upon the exporting ship. A note is prepared and signed as in the case of bonded goods; and on production to the proper officers—either of Customs or of Excise—of the certificate of exportation, a document known as a debenture is handed to the exporter, and this authorises the repayment of the amount of duty.

BOUNTIES AND SUBSIDIES.—These constitute a method by which governments have encouraged the production and export of goods. The policy, far from being a new one, was an integral part of the mercantilistic system of trade regulation, though, during the nineteenth century, it fell into disuse, so far as Great Britain was concerned. In recent years, however, it has been employed on an increasing scale.

A *bounty* has been defined as the payment by the State of a definite sum per unit of commodity produced or exported. A *subsidy*, on the other hand, is a payment by the State on any other basis, for example an annual lump sum payment. In current literature, the two terms are used interchangeably. Sometimes a subsidy is granted upon the condition that some service shall be rendered to the State, as for example the subsidies to steamship lines which have been made on the condition that they should maintain special services for the carriage of mails. In such cases, the real subsidy consists in the excess of the payment received over the cost of rendering the service to the State—a sum which it is probably impossible to calculate with any degree of accuracy.

British subsidies prior to the outbreak of the Second World War were designed to help the home producer rather than to stimulate exports. During the Second World War food subsidies were introduced to stabilize the cost of living and thereby prevent inflationary wage movements. In the year 1940–41 the Government paid out £63 million in subsidies. This figure has risen to such an extent that the Chancellor of the Exchequer, in his Budget for 1949, had to fix food subsidies at £465 million, but since that date most of these subsidies have been removed.

TEST PAPER

1. What are Customs duties and for what purposes are they levied ?

2. What information must be furnished by a person importing foreign goods into this country ?

3. Explain the nature of the Ship's Report.

4. State clearly the use of the document known as an *entry* in connection with imported goods.

5. Into what two groups may imported goods be classified ?

6. If a consignment of fruit were sent to you, what entry would you have to pass before obtaining permission to remove the goods ?

7. Mention the two alternatives open to the importer when dealing with dutiable goods.

8. How would you clear dutiable goods intended for immediate home consumption ?

9. A merchant receives a consignment of dutiable goods which are not required for immediate use. What entry is he required to make in such a case, and what steps would he take to obtain delivery of the goods when they are required for use ?

10. An importer of foreign goods has to "declare" the consignments he receives. What is meant by "declaring" goods and how is it done ? What is the procedure followed by an importer to obtain possession of dutiable goods ?

11. When goods are imported with the intention of being re-shipped to another country, is it necessary to pass any Customs entry ?

12. Describe the treatment of imported goods whose exact description is unknown.

13. Mention any goods whose importation into this country is prohibited.

14. What is the difference between Customs Duties and Excise Duties ?

15. Give a broad classification of Excise Duties.

16. Enumerate some of the most important commodities which are subject to Excise.

17. Explain the meaning of the terms "Drawback," "Bounties," and "Subsidies."

18. Distinguish between specific and *ad valorem* duties. If goods which have paid customs duty on entering this country are subsequently exported, can the trader recover the duty paid ? If so, state the procedure.

CHAPTER XXXI

Organisation of the Export Trade

INTRODUCTION.—In opening up a new market for his goods in a foreign country, the intending exporter should first make investigations into the following points—

(1) The financial and political conditions prevailing in the country to which the goods would be exported.

(2) The extent of the needs for the commodities in question, together with the purchasing power of the probable consumers.

(3) The conditions of sale.

(4) The terms of payment and the nature of the banking facilities.

(5) The Customs duties and the question of consular invoices; and the manner in which the Customs officers treat the packing when examining whether the goods are or are not dutiable.

(6) Any legislation concerning the manufacturer's trade marks and the method of litigation in case of non-payment.

(7) The method of procedure in entering into business relations with intending customers.

(8) Any particulars relative to the goods which he proposes to export, such as qualities and quantities consumed, selling price, kinds of packing, existing competition, etc.

EXPORT ON CONSIGNMENT.—The method adopted in early days was that of *consignment.* The manufacturer forwarded to the commission agent a quantity of goods, and the latter did his best to dispose of them in the interests of his principal. The proceeds of the sale were remitted to the principal after the deduction of the expenses incurred. However, trade on consignment tends more and more to disappear. It is necessary to keep in constant touch with the consignee and to repose in him an unlimited confidence. Sometimes the consignee is tempted to abuse this confidence by the neglect of his engagements, by understating the amount he has actually received for the goods, or by submitting an exaggerated statement of his expenses. There are also other risks. The market prices might undergo a serious alteration during the transport of the goods, and a consignment calculated on a basis from which a profit was anticipated would then be

converted into a loss. Finally, the methods of communication have improved, so that it is no longer necessary to maintain huge stocks at oversea depots for the convenience of purchasers. Orders can now be so executed as to spread the delivery of the goods over a certain period.

MEMBERS ENGAGED IN THE EXPORT TRADE.—A large proportion of the goods manufactured in the British Isles is exported to foreign countries in exchange for food-stuffs and raw materials. On account of the essential difference in the nature of the imports and exports, the present organisation of the British export trade, which is concerned mainly with manufactured goods, differs materially from the import organisation. The form taken by the export organisation is illustrated by the diagram on page 300.

From this diagram it will be seen that, generally speaking, the following members take part in the export of goods, say, from England to India—

(1) The Manufacturer.

(2) The Firms engaged in the collection of the goods from the Manufacturer.

(3) The Wholesale Merchant or Commission Agent engaged in the Export Trade.

(4) The Agent in the foreign country (i.e. India).

(5) The Importer in India.

(6) The Wholesale Merchant.

(7) The Retail Dealer.

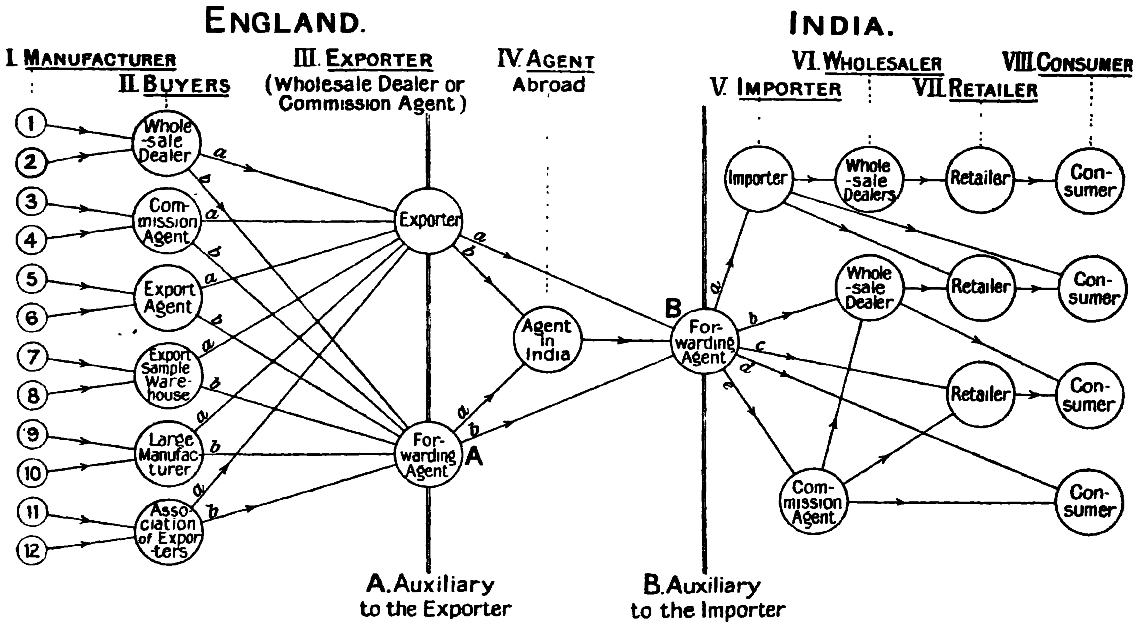
(8) The Consumer in India.

Each of these members has his definite function to fulfil, according to the extent to which the principle of division of labour has been carried, and according to the magnitude of the transactions undertaken. Since these functions are not entirely different from those of the corresponding members in the import trade, it will be sufficient here to explain the special duties of the exporter in England and the importer in India.

The export of goods is undertaken by three different types of trader—

(1) The *Commission Agent* who acts as buyer for merchants abroad. On receipt of an indent from his principal, he orders the goods from manufacturers at home, and then ships them under his own invoice.

EXPORT OF MANUFACTURED GOODS



(2) The *Wholesale Merchant*, who exports his own manufactured goods to buyers or branch houses abroad.

(3) The *Forwarding Agent*, whose operations are usually restricted to the receipt, packing, and forwarding of goods sent to him by different traders in this country.

The Commission Agent. The commission agent engaged in the export trade acts as a direct buyer of manufactured goods in the entire sphere of his purchasing area. He acts in his own name, but for the account of either the foreign buyer or importer or on behalf of the home manufacturer. For instance, an English commission agent may receive an indent for various kinds of goods from a buyer in India. His first duty would be to obtain from the various makers their prices for the goods and the time required for their delivery, and on receipt of these particulars he would place his order with the firms offering the best terms. Thus, he would be acting as intermediary between the home manufacturer and the Indian buyer. Again, the English manufacturer might induce the commission agent to export a consignment of his goods to some district in India, in the hope that there would be a demand for them at profitable prices. In this case, the commission agent would be acting on behalf of the English manufacturer, and not for the Indian buyer.

The commission agent engaged in the export trade must have a special knowledge of the goods in which he deals. He must not only understand the various kinds and qualities of the articles produced, but must keep in close touch with the movements of their prices and with any alterations which take place in the process of their production. His next duty is the linking up and gradual extension of his business connection with foreign buyers, and the application of the best methods for facilitating the sales. The essential conditions for the attainment of this end are to be found in the residence in the foreign country for many years, in the wise selection of agents, the opening up of business relations with other commission agents, and the establishment of foreign branches and places of sale.

In his dealings with the manufacturer, the commission agent acts in the interests of his principal (i.e. the foreign buyer), and insists on the goods being made according to sample, and on the date fixed for delivery being adhered to. He also effects the work

connected with the dispatch of the goods, such as the arrangements with the shipowner, the preparation of the Bill of Lading, the procuring of the Customs documents, the effecting of insurance, etc. In his dealings with the foreign buyer, the commission agent acts in the interests of the manufacturer with regard to the fulfilment of the contracts, the receipt of the goods, and the payment for them.

Thus, the commission agent engaged in the export trade places at the service of the two parties brought together in his name, not only his trade organisation, his experience and knowledge acquired in the course of many years, but also the reputation and good name of his house. More than this, he represents both parties with his capital and his credit, and bears many risks which will be alluded to in a later chapter.

The Wholesale Export Merchant. The wholesale merchant engaged in the export trade performs practically the same services as the export commission agent, except that he concludes the purchase and sale of the goods for his own account, and derives his profit from the difference between the purchase and the selling price of the goods. On the other hand, the commission agent draws a fixed commission, to which may be added, by arrangement, certain increments due to the fluctuation of the exchanges, discounts accorded to him by insurance and shipping firms, etc.

The Forwarding Agent. The duty of the forwarding agent differs from that of the above two members of the export trade in that he is not usually entrusted with the buying of the goods. The orders are sent direct by the customer abroad to the English trader or manufacturer, and in payment the latter usually receives a direct remittance.

On the employment of a forwarding agent, the English manufacturer supplies him with an *Advice Note* containing instructions relating to the goods which are to be consigned. In case the goods are dispatched from a place in which the forwarding agent has neither a representative nor any organised system of conveyance, they are addressed by the manufacturer to the forwarding agent. The latter, on taking possession of the goods, attends to their freighting in accordance with instructions; executes all necessary shipping formalities, such as the preparation of the Bill of Lading, Customs declarations, etc. The goods

having been dispatched, he has next to send instructions and documents to the forwarding agent abroad, if such a person be employed. If the forwarding agent has also to effect the insurance, he fills up the necessary proposal form, forwards it to the insurance company, and receives the policy in return. Sometimes the forwarding agent himself is the representative of an insurance company: in that case, the insurance begins to operate immediately it has been entered in the register kept for that purpose.

THE IMPORTER.—The foreign importer may be a separate person or firm, or a person in partnership with the exporter. His work is not less difficult than that of the exporter, since it is his duty to direct the sale for a wide area from his particular centre. He must have a good knowledge of the requirements of the native consumer or of the people residing in his selling area, and must post his indent or order in good time so that he will be in possession of the goods when they are required. Further, he has to effect all work connected with the receipt of the goods, such as the checking of the goods, the upkeep of the warehouse, and the execution of the sale, as well as other matters incident to the transactions. Moreover, the importer must also place his capital and credit in the service of his undertaking; and must bear a number of risks, even though he is conducting the business, not on his own account, but as commission agent in the service of the English exporter or manufacturer, or even on account of the wholesale merchant or retailer in his own country.

RISE OF THE EXPORT AGENT.—In addition to the functions performed by the above principal members, there are also a number of particular services to be rendered in the export trade by special representatives of the commodity; and especially where the importation of the goods is effected without the aid of an exchange, as usually in the case of ready-made goods. Of recent years in this connection there has been enlisted the services of a special trader known as an *Export Agent* (see diagram), whose duties are similar to those of the wholesale export merchant, since he represents the home manufacturer. As a rule, sample rooms are kept by the export agent in the chief exporting centres, which facilitate the exporter in his selection of goods and in his giving of orders, as well as saving him the trouble and expense of making journeys to the places of manufacture. These sample rooms, which are

sometimes known as Export Museums, may be organised directly by the manufacturers, whose aims are then similar to the dairy farmers who provide themselves with a selling association, or similar to that of the wholesale salerooms in Manchester in connection with the co-operative distributive societies.

CONCLUSION.—As the commission agent and wholesale merchant engaged in the export trade are in co-ordinate relationship to each other, it will be found from a study of the diagram on page 300 that there are usually six persons involved in the exportation of manufactured goods. In addition to the manufacturer and the consumer, there are—

(1) The Exporter (No. III).
(2) The Importer (No. V).
(3) The Wholesale Merchant (No. VI).
(4) The Retailer (No. VII).

Thus, the goods generally pass through four different hands in the course of their distribution, and are subject four times to an increase in price. In the case of manufactured goods, this additional increment to the cost of the goods is greater in proportion to the magnitude of the labour and risk involved than in the case of the importation of raw materials. It is, therefore, natural that in the exportation of manufactured goods, there is a tendency to eliminate the middleman wherever possible.

This elimination will often take place once a fairly sustained flow of goods has been secured, or market research has shown that a good market exists and can, with proper attention, be built up. Then firms who import regularly and in quantity from another country will probably set up their own Buying Office in the country of origin of the goods. Or a manufacturer or exporter of goods who has found a steady market in other countries may set up Foreign Subsidiaries in the selling countries to dispose of his goods. By establishing these foreign subsidiaries under the law of the country in which they are to operate many of the difficulties of Customs clearance and settlement of debts are solved, and the subsidiary can concentrate upon enlarging its principal's market without the divided loyalties which an agent handling several manufacturers' goods would have.

TEST PAPER

1. **Enumerate the chief members engaged in the Export Trade.**

2. Copy the diagram on page 300 and explain the function of each of the members marked in roman figures.

3. Describe the work of the Commission Agent engaged in the Export Trade.

4. In what respect does the Wholesale Export Merchant differ from the Commission Agent engaged in the Export Trade ?

5. Explain carefully the services rendered by the Forwarding Agent in the Export Trade.

6. Compare the duties of the exporter with those of the foreign importer.

7. What steps have been taken to eliminate middlemen in export trade?

CHAPTER XXXII

Transactions in the Export Trade

The chief stages through which an export transaction has to pass are as follows—

(1) The receipt of the indent from abroad.
(2) The placing of the orders contained in the indent.
(3) The packing and forwarding of the goods.
(4) Shipping the goods.
(5) Effecting the insurance.
(6) Invoicing the goods.
(7) Drawing Bills of Exchange against shipment.

RECEIPT OF INDENT FROM ABROAD.—The first step in an export transaction is the receipt from abroad of the merchant's indent or order for goods which he requires to be shipped to him. The particulars usually provided by an indent are—

(1) Details of the goods required.
(2) The price.
(3) Packing and shipping instructions.
(4) Date of shipment.
(5) Method of reimbursement.

On page 307 is a copy of a simple indent received from Messrs. J. Edwards & Co., of Cristobal, by George Penny & Co., Commission Agents, London.

PLACING OF ORDERS.—Messrs. Penny & Co. first dissect the indents they receive so that the orders for the various goods mentioned in them can be properly placed with the manufacturers and wholesale dealers who are best able to supply them. The above indent contains but one item, viz., 1,000 barrels potatoes, and the commission agent will probably inquire for quotations of several firms prior to placing the order.

The selection of goods, or buying, is a matter in which practice varies a good deal. In some houses one or more buyers, knowing both home and foreign markets, are employed; in others, the partners of the firm undertake the duty, with the occasional assistance of their senior clerks; whilst in others the selection is practically left to agent or packers in the various towns and

Indent

INDENT No. 50. *Cristobal,*

................19

Messrs. GEORGE PENNY & Co.,
London.

Please purchase and ship to us by an early steamer of the ....*R.M.*.... Line, the goods named below. You will insure them for the amount of your Invoice, adding ....10...% for imaginary profit, and for your reimbursement, please draw on us in favour of the ....*Colonial*.... Bank, with which we have arranged that your Draft on us, with documents attached, shall be accepted as cash, discount and premium being placed to our account.

J. Edwards & Co.

Marks, etc.	Description of Goods.	Remarks.
J.E.&Co. Cristobal	1,000 *barrels Potatoes, each about* $1\frac{1}{2}$ *cwts. net, at lowest possible price.*	

cities, to whom the orders are sent, and who make all the necessary purchases and arrangements, charging a small commission for their trouble.

There are, of course many kinds of goods in which no special, selection is necessary, or which can be ordered from sample, brand, or trade mark, such as wines, spirits, beer, soap, candles, pickles, sauces, jams, salt, scrap pig or other iron, biscuits, potted and canned meats and fish, in all of which a very extensive export trade is done.

The replies to the inquiry for quotations for potatoes will be received and we will assume that the lowest quotation is that received from Messrs. J. Abbott & Co., viz. 8s. 6d. per barrel, f.o.b. London.

In reply to the quotation made by Abbott & Co., it is assumed that a further communication is addressed to them containing a counter offer of 8s. 3d. per barrel, and that this is accepted.

The acceptance of the counter offer completes the contract between the parties, and would be embodied in a confirming letter.

The fact that the order had been placed would also be communicated by the Commission Agents to the Principals.

PACKING AND FORWARDING GOODS.—The order having been placed, full directions as to the marks and numbers to be put upon the barrels would be furnished to Messrs. Abbott & Co., together with the name of the port, dock, or goods station to which the goods are to be sent, as well as the name of the ship by which they are to be shipped and her destination.

Next would follow an advice that the goods are being sent forward, and the invoice will come to hand as follows—

Merchant's Invoice to Commission Agent

WRAY STREET,
LONDON, E.4.

INVOICE.

Messrs. GEORGE PENNY & Co
E.C.2.

To JOHN ABBOTT & CO. *Dr.*

Potato Merchants.

To 1,000 barrels Potatoes each about $1\frac{1}{2}$ cwts. net. at 8s. 3d. per barrel f.o.b.	£412	10	0
Total Gross weight. 80–12–1–13			
Total Net. weight. 73–11–0–12			
E. & O. E.			

The advice and invoice having been received, it is the duty of one of the clerks to look out for the due arrival of the goods mentioned in the invoice, and also to attend to such other operations outside the counting-house as may be involved. In the meantime the invoice will be examined and prices compared with the order before payment of it is made.

SHIPMENT OF GOODS.—The next step in the exportation of the goods is the preparation of the Bill of Lading. This is, when signed, the actual representative of the goods. Bills of Lading are usually drawn in sets, the number in a set being at the option of the shipper. Generally, there are three; they no longer bear a sixpenny revenue stamp. The Bills of Lading are signed by the

master of the ship or by someone on his behalf. When signed, they are handed to the shipper of the goods, since they are his property. With each set of Bills of Lading, an extra copy, which is not for signature, is furnished to the shipbroker for the use of the master, and should be marked "Master's Copy." The *Bill of Lading* for the consignment of potatoes to Demerara is shown on page 310. It will be seen that the particulars required in such a document are—

(1) The name of the shipper.
(2) The name of the ship.
(3) The place of loading and destination of the ship.
(4) A description of the goods shipped.
(5) The place of delivery.
(6) The persons to whom delivery is to be made
(7) The weight on which freight has to be paid.
(8) The date.

If the shipper should choose to omit the name of the consignee on the face of the Bill of Lading, he may consign the goods " to order," in which case he must, before parting with it, endorse the document in order to make it available at the port of discharge. When a merchant is dispatching goods by the same vessel to several consignees, a separate Bill of Lading must be made out for *each* separate shipment.

Before preparing the Bill of Lading, it is always well to ascertain beforehand that the goods are sure of being dispatched by a certain ship. At times of pressure on a particular vessel, goods are often shut out for want of room. It is now the custom of important steamship lines to require their shippers to use a special form of Bill of Lading, in which various stipulations as to what they will or will not be liable for are embodied. There are also special forms used for particular trades, the chief differences in which are the clauses at the end. The essential features of the document, however, are the same. The Bills of Lading, when made out, are taken to the office of the broker of the ship and left there in order that the signature of the master or his representative may be affixed. This is done after they have been examined to see that all the goods named on them are shipped. In due time, the shipper applies for their return and hands over in exchange for them the mate's

ROYAL MAIL LINES, LIMITED

WEST INDIES ROUTE

OUTWARDS FOR USE AT UNITED KINGDOM PORTS
TO
WEST INDIES, SPANISH MAIN & CENTRAL AMERICA (ATLANTIC PORTS)

Packages.

SHIPPED in apparent good order and condition by *George Penny & Co.*
on board the Ship *s/s Pergon* sailing from the Port of *London*
on a voyage as described by Clauses 5, 6 and 7 at back hereof, always without warranty of customary or advertised dispatch or route

N.B.—Shippers are asked to note that they should only enter in this space either the number of packages or pieces or the quantity or the weight. *1000 barrels*

(with leading marks as below but all other particulars unknown) to be carried and delivered subject to all the exceptions, limitations and conditions hereinafter agreed at the Port of *Cristobal*
or as near thereto as the carrying Vessel may safely get and always lie afloat or (at Carrier's option) as agreed in Clauses 12 to 21 at back hereof unto *Messrs. J. Edwards & Co.* or to his or their Assigns.

Particulars Furnished by Shippers under Articles III and IV of the Rules comprising the Schedule to the Carriage of Goods by Sea Act, 1924

Declared Marks and Numbers	Packages		Declared Contents	Value	Gross Kilos	Measurement		Weight			
	No.	Declared Description				Feet	Inches	Tons.	cwt.	qrs.	lbs.
J.E.&Co. *Cristobal*	*n/n*	*1000 barrels*	*Potatoes*					*80*	*12*	*1*	*13*

Consulage . . ...
Wharfage . ... .. per freight ton
Port Charges . .... per freight ton
Surcharge .. .. per 1,000 kilos
Despatch Fee ....

IN WITNESS whereof the Master or Agents of the said Ship and its connections have affirmed to ....*Three*....Bills of Lading each of this tenor and date, one of which Bills being accomplished, the others to stand void.

Dated in....*London*....*26th*....day of....*April*....19..

....
For the Master and Owner

receipts for any goods which have been loaded direct on to the ship from a barge instead of from the quay. The mate's receipt for the above-mentioned consignment to Cristobal would be as follows—

Mate's Receipt

> Received on board the s.s. *Pergon* for CRISTOBAL
>
> J.E.&Co. 1,000 barrels Potatoes
> Cristobal *ex* barge *Luna*
>
> (Signed) J. THOMAS,
> Mate.

The Bills of Lading are now in the possession of the shipper, and it becomes necessary to dispatch one or two of the set to the consignee (or to the banker as in this case), in order that he may be able to secure the goods on their arrival at the port of destination. One copy is sent as quickly as possible after the sailing of the ship, and another by a succeeding mail, the object being to secure the arrival of one out of the two, in case of loss or miscarriage of the other. The third part is retained by the shipper and kept with the other documents relating to the shipment.

With British shipowners, it is customary for them to secure, as far as they possibly can, all their freights at home; that is to say when their ships come from foreign ports the freight on the goods they bring is paid on the discharge of their cargoes, but when they go out to foreign ports, the freight is payable in advance. When this is the case, the shipbroker puts on each Bill of Lading the amount of freight payable for carriage of the goods named on it, and it is sometimes required that the freight must be paid before the Bills of Lading are given up.

It is the duty of Penny & Co. to see that the freight account is correct before payment is made, and that the rates are those agreed upon. In this respect, it is well to remember that a ton of shipping varies somewhat, it usually being 40 cubic ft. in the case of goods which are bulky, whilst for heavy goods the ordinary ton of 20 cwt. is used.

* **SPECIFICATION for British and Irish Goods only.**

Port of London *Ship's Name* Pergon *Master,* James Mason *for* Cristobal

Date of Final Clearance of Ship 26/4/..

* The Specification of Goods exported must be delivered to the proper Officers of Customs within six days from the time of the final clearance of the Ship, as required by the Customs Laws.

Marks	Numbers	Description of Packages	Quantity and Description of British and Irish Goods in accordance with the requirements of the Official Export List	Weight Cwt.	Weight qrs.	Weight lbs.	Value ‡ (f.o.b.)	Final Destination of the Goods
J. E. & Co CRISTOBAL	n/n	1000 Barrels	Potatoes	1471	—	12	£412 10 0	Cristobal
				Total			£412 10 0	

‡ The "F.O.B." or free on board, value should be given

I declare that the particulars set forth above are correctly stated.

Date 26th April 19..

Signed George Penny & Co. †

Address 165 Fenchurch Street

† Adding Exporter or Agent, as the case may be.

Countersigned ______________ *Officer of Customs.*

Within six days of the clearance outward of the ship, the exporter is also required to deposit with the Customs Authorities a specification of the goods which he has exported. This will be entered by Penny & Co. on the form known in official language as the " Specification for British and Irish Goods only," a copy of which is shown on page 312. The particulars given on this form must be in accordance with the Customs export list, and have reference to the weight or measure and value of the goods. This information is used for statistical purposes; and to ensure its being given, the broker of every ship leaving any port in the British Isles is required under a penalty to deposit with the Customs within six days of the clearance outwards, a manifest which must contain full particulars of the whole of the cargo. If any goods shown in the manifest do not appear in the specifications, the Customs House authorities are able to apply to the shipper to remedy the omission. On the other hand, if goods appear in the specifications and not in the manifest, the broker can be called upon to explain.

EFFECTING INSURANCE.—The goods having been shipped and the Bills of Lading secured, the exporter's remaining duty is to effect such insurance on them against sea risks as he may think fit. It is customary to insure exported goods for such an amount as will cover not only the value of the goods as shipped, but also a reasonable profit, and such a sum as would cover any expenses which would be incurred in the event of the loss of the goods or any part of them by perils of the sea.

The insurance will be effected through the medium of an insurance broker, who receives his remuneration not from the merchant for whom he acts, but *from the underwriters*, in the form of a reduction of 10 per cent on the premiums he arranges to pay.

The method of procedure is for the broker to write on a slip the particulars of the insurance he desires to effect, and if it is intended by the owner of the goods to insure against total loss and general average loss only, he puts on the slip the letters " F.P.A.," which mean " Free of particular average," or, if the ship which carries the goods belongs to a nation which is then at war with any other nationality, the underwriters will demand that the insurance shall be " F.C.S.," or, " Free of capture and seizure," unless they are paid an extra premium to cover " war risk." When goods are

SIGHT DRAFT

No. [redacted]

SOLD BY E. COX & SONS NEW COURT GATEWAY CAREY STREET CHANCERY LANE LONDON W.C. ESTD 1802

2D STAMP

April 26th 19.. For £ [redacted]

At Sight Pay this First of Exchange Second unpaid to the Order of The Colonial Bank

[redacted]

Value Shipment of 1000 barrels potatoes S/S "Pergon" which place to Account.

To Messrs. J. Edwards & Co.

George Penny & Co.

insured " F.P.A.," the risk borne by the underwriter is considerably reduced, since he is not liable for any damage or injury to them, but only for total loss and general average loss, the owner of the goods taking any risk of damage. Having arranged his slip, the broker either writes on it the premium he is willing to pay or, without stipulating the premium, presents the slip to one of the underwriters with whom he usually does business.

INVOICING THE GOODS.—The shipment of the 1,000 barrels of potatoes having been completed, the next duty is to prepare the *export invoice* relating to the transaction, which is a matter of no small importance. Where there are several items, all the invoices received from the different tradesmen at home must be got together with the various Railway and Dock Bills for carriage and wharfage relative to them, and all other accounts and documents concerning the goods, such as Freight Notes and Custom House agent's charges. In case there are several kinds of goods drawn from different sources, it is not necessary to detail the prices and quantities, but only to give particulars of marks and numbers, and against each separate parcel the name of the persons supplying the goods, with the amount of their account for them. Copies of the original invoices are usually attached, and these give to the receiver at their destination full particulars of prices, weight, measure, and other particulars it is necessary for him to know. After the whole of the suppliers' accounts have first been set out, the amounts are added together, and the first, or net cost of the shipment is shown.

The charges or expenses, as Freight, Insurance, Bills of Lading, Dock Dues, and all other incidental expenses, are next grouped together. These, again, are totalled, and the sum of them is added to the cost of the goods. Finally, the sum of the net cost plus the expenses is added to the merchant's charge of commission for buying and shipping the merchandise dealt with in the invoice.

DRAWING BILLS OF EXCHANGE AGAINST SHIPMENT.—Being now complete, the invoice is next dispatched to the consignee of the goods.

At the same time, a letter is forwarded to the Colonial Bank by Penny & Co., asking them to collect the amount of the above-mentioned invoice. In accordance with the consignee's request, a sight draft is made out, and this, together with two Bills of Lading,

copy of the invoice, and the insurance policy, are all sent to the banker in London. The latter, in turn, forwards them to his agent in Cristobal, who does not part with them until the amount of the draft is paid. When this is done, the consignees, Messrs. J. Edwards & Co., are at liberty to take charge of the goods mentioned in the Bill of Lading.

In this example it was assumed that the order originated from a buyer abroad who instructed the agent in this country to reimburse himself by drawing a Bill of Exchange. Where the export transaction originates as an order from a concern abroad to a manufacturer or exporter in this country, it is the usual procedure now for the exporter to insist upon the potential buyer first opening a documentary credit with his bank. His bank then informs the exporter's bank in this country that a credit has been opened and details the documents to be sent following shipment of the goods. In this way the liability for payment rests with a bank, and not with a trader about whose credit status the exporter may have little knowledge. The procedure outlined is then followed, but the Bill of Exchange, to which all shipping documents are attached (it is known as a Documentary Bill) is then sent direct to the buyer's bank for payment at sight or at an agreed period after sight. This procedure removes the credit risks attached to dispatching valuable goods to foreign buyers who are not known to the exporter.

TEST PAPER

1. Mention the chief stages through which an export transaction has to pass in the course of its execution.
2. Explain the meaning of an Indent, and say what particulars are furnished by it.
3. On receipt of an Indent by a Commission Agent, what are his duties?
4. When goods are packed for export, how are the packages made easy of identification?
5. What information is contained in a Bill of Lading?
6. Explain the use of a Mate's Receipt.
7. Explain the mode of procedure when effecting the insurance of goods intended for exportation.
8. You are an exporter of stationery, and have received an order from Melbourne for your stock lines, value, say, £1000. State the procedure you would follow in getting the goods to your customer in Melbourne.
9. What is a "Documentary Credit?"

CHAPTER XXXIII

Documents and Terms Used in the Export Trade

The special problems of export trade, occasioned by the fact that the goods must cross frontiers and be subject to customs duties and quotas, that payment frequently involves a currency exchange, and that price quotations must clearly define which of the many expenses involved in the transportation of the goods fall to the seller or to the buyer, have given rise to special terminology and documentation.

Taking the latter point first, the cost of goods purchased abroad is increased, by the time they arrive in the hands of the purchaser in this country, by carriage to the foreign port, dock handling charges in that port, loading charges, freight for the sea passage to the home port, unloading and dock handling charges there, possibly warehousing charges, the payment of any customs duty, and carriage from the home docks to the place of business of the purchaser. In addition they should be insured throughout the journey.

It is obvious that with so many additional expenses to be taken into account, it is of great importance when quoting prices for goods to be exported that both parties to the deal should be quite clear as to what is included in the price quoted and what is not. There have, as a result, grown up a number of recognised priced quotations which indicate to both parties where the incidence of these various costs will lie. The terms used in this connection are as follows—

Loco, or ex Works—The price of goods at the factory or warehouse of origin, the buyer paying all movement costs.

F.O.R. (Free on Rail)—Price includes packing and delivery to railhead at place of origin.

Delivered Docks—Price covers delivery to docks at port of despatch, but not dock handling charges.

F.A.S. (Free Alongside)—Price includes delivery to docks at port of despatch and handling charges up to placing the goods alongside the ship which is to take them, but not loading charges.

F.O.B. (Free on Board)—Price includes above plus loading on to the ship.

C.F. (Cost and Freight)—Above charges plus freight charge for sea passage.

C.I.F. (Cost, Insurance, Freight)—As above plus the cost of insuring the goods through to destination.

C.I.F.E. (Cost, Insurance, Freight and Exchange)—This adds cover for the possibility of a change in the rate of exchange between two currencies involved in the transaction.

LANDED—Above charges plus unloading charges at port of arrival.

IN BOND—Above plus handling charges up to goods being placed in bonded warehouse awaiting payment of customs duty.

DUTY PAID—All charges through to port of arrival, including customs duty, so that the buyer has only to pay for collection from the docks.

FRANCO (Free, or Rendu)—All charges up to delivery to the buyer are included in the quoted price.

This list is not exhaustive in the expenses covered or the combinations of coverage which may be arranged, but it is obvious that great care must be taken in arranging an export contract to determine the exact coverage given and just what is left as an additional expense to the buyer. Of these terms F.O.B. and C.I.F. are the most commonly used.

GOODS ON CONSIGNMENT.—When goods are dispatched on consignment to be disposed of by an agent on commission the following terms and documents may be referred to:

(*a*) Pro-forma Invoice: This is an invoice showing the details of the goods as dispatched to the consignee for disposal. As this dispatch is not a sale to the consignee, the invoice is not intended to be a document notifying a charge made, as is its usual function. The price quoted on it may be cost price, the selling price which the consignee is to charge, or an indication of a minimum price below which he must not sell.

(*b*) Account Sales. When the consignee has sold goods he will send his principal, the consignor, an Account Sales, showing the goods he has sold and the price realised, less any expenses he has incurred and his commission. The net balance is the amount he holds for the credit of the principal which he will remit according to instructions.

(*c*) Account Current. When there is an agreement that accounts between principals and agents shall run for stated intervals with interest being allowed on the items therein either way, an account

current is kept between the parties. Interest is calculated upon the fluctuating balances, and when settlements are made the balance of interest due is added to the account of, or remitted to, the party to whom it is due.

(*d*) Del Credere Commission. Consignees will receive an agreed commission on the proceeds of sales which they make on behalf of their consignors. Sometimes a consignee will agree to guarantee his consignor against any insolvency of customers arising from sales made by him; that is to say that if anyone to whom he has sold the principal's goods becomes insolvent, the consignee will pay the consignor. In this event it is agreed that an additional rate of commission—a del credere commission—shall be payable to the agent.

VALUATION FOR CUSTOMS DUTY.—Customs duties on goods entering a country may be either ad valorem duties (based on the value of the goods) or specific duties (a fixed amount for a specific article irrespective of its price). In addition, the rate of duty may vary according to the place of origin of the goods where a country has by treaty agreed to extend a preferential rate of duty to certain other countries' goods.

For the purpose of determining the appropriate rate of duty applicable some countries require imported goods to be accompanied by a Certificate of Origin, or a Consular Invoice, or—a combination of the two—a Certificate of Origin and Value. These state value and origin of the goods on forms framed to suit the requirements of the country concerned and are certified by the Consul of the importing country in the country from which the goods are exported.

Export sales also usually involve the use of Letters of Credit or Documentary Credits—the banking documents in connection with payment referred to in the previous chapter.

TEST PAPER

1. Explain the terms "loco," F.O.B., C.I.F., and Franco, in connection with the price of goods.

2. A merchant may quote a price for goods F.A.S., which means that the price includes the cost of conveying the goods to the ship's side. Mention five other kinds of prices commonly quoted for goods, give their commercial abbreviations, and explain exactly what the prices mean.

3. Taking a "loco" price as a basis, name what additions would be required to make this into—
   (*a*) a C.I.F. price   (*b*) a Franco price.

4. What is a Consular Invoice, and what purpose does it serve?

5. What is a Certificate of Origin, and for what purposes are such documents used?

6. Explain what is meant by an "Account Current," and make out such an account for Alfred Bridger in respect of the following transaction with Harry Curtis—

19—.		
Jan.	17.	Goods sold to Harry Curtis, £200, due 1st February.
Feb.	1.	Received cash from Harry Curtis, £50.
Mar.	18.	Goods bought of Harry Curtis, £300, due 1st April.
Apr.	1.	Paid to Harry Curtis, cash £200.
May	1.	Goods bought of Harry Curtis, £150.
„	10.	Goods sold to Harry Curtis, £120, due 1st June.

The account to be made up to 1st June, 19—; interest to be at 6 per cent per annum, which may be calculated by months instead of days.

ABBREVIATIONS USED IN TRADE

A/S	Account sales
A/C	Account current
Ad val.	*Ad valorem* (according to value)
Appro.	Approval
A/T	American terms (grain trade)
@	At; for; to; from
B/d	Brought down
B/f	Brought forward
c. & f.	Cost and freight
C/N	Credit note
C/d	Carried down
C/f.	Carried forward
Cert. Inv.	Certified invoice
Ch. fwd.	Charges forward
Ch. ppd.	Charges prepaid
C.i.f. & c.	Cost, insurance, freight, and commission
C.i.f. & i.	Cost, insurance, freight, and interest
C.i.f.c. & i.	Cost, insurance, freight, commission, and interest
Con.	Contra (against)
Con. Inv.	Consular invoice
C.w.o.	Cash with order
C.H.	Custom house
C.W.S.	Co-operative Wholesale Society
D.bk.	Drawback
Deb.	Debenture
D/O	Delivery order
E. & O.E.	Errors and omissions excepted
E.E.	Errors excepted
E.g.	*Exempli gratia* (for example)
Enclo.	Enclosure
Exors.	Executors
Exs.	Expenses
F.a.q.	Fair average quality
Fco.	Franco (free)
F/d	Free docks
F.o.b.	Free on board
F.o.c.	Free of charge
Fol.	Folio
F.o.T.	Free on Trucks
G.m.q.	Good merchantable quality
Gr.	Gross
Grs.	Grains
Hhd.	Hogshead
H.P.	Horse-power
I.B.	Invoice Book
Id.	Idem—the same
I.e.	*Id est*—that is
Kilo.	Kilogramme
£T.	Pound Turkish
£E.	Egyptian pounds
L.m.c.	Low middling clause (cotton)
M/u	Making up (price)
MM.	Messieurs, sirs
M/R	Mate's Receipt
MSS.	Manuscripts
N.B.	Take note—mark well
Nos.	Numbers
P/A	Power of Attorney
P.L.A.	Port of London Authority
Pcs.	Pieces (of cloth)
P/C	Price current; petty cash
Pkg.	Package
Qlty.	Quality
Qr.	Quarter
q.v.	*Quod vide*—which see
R.	Rupees
rm.	Ream
s/d	Sea-damaged (grain trade)

ABBREVIATIONS USED IN TRADE—*contd.*

seq.	The following	**Via**	By way of
Spec.	Speculation	**W/B**	Way bill
Sq.	Square	**Wd.**	Warranted
T.M.O.	Telegraph money order	**Yds.**	Yards

SECTION V—EXCHANGE, BANKING AND FINANCE

CHAPTER XXXIV

Money and Exchange

The buying and selling of goods dealt with in the preceding section call for various means of payment and for banking facilities to finance the firms which manufacture the goods and those concerned with their distribution.

MONEY.—Commerce did not spread to any very great extent in the days of barter economy because exchange in these circumstances is only possible if *A* has goods which *B* wants and *B* is prepared to give in exchange goods which *A* wants. This double coincidence of wants will not often occur, and even when it does there is still the problem of valuing one type of goods in terms of the other and determining the exchange value.

Money is a third commodity introduced into commercial exchanges with a view to facilitating them. It must be something of general acceptability which those who sell goods or services to another will be prepared to take in exchange, knowing that when they in turn wish to buy goods or services from others they can tender this money in exchange and be sure that it will be accepted.

Money is, therefore—

(*a*) A medium of exchange—enabling exchanges to take place freely.

(*b*) A measure of value—since the value of all goods and services can be expressed in terms of money (the price) so as to give exchange values.

(*c*) A store of value—enabling those who do not wish to spend immediately to save money in the present with a view to spending it in the future.

In various communities and at various times "money" has taken many different forms—cattle, beads, shells, and various commodities have served the purpose. Later most communities came to adopt the precious metals gold and silver as their money and in more recent

times these have been replaced by banknotes and the "token" coins (the intrinsic value of which is not related to their face value) which we use today.

There are two essential qualities required of any form of money—namely, it must be acceptable to all people in the area in which it is to circulate, and it must have reasonable stability of value.

ACCEPTABILITY.—Obviously nobody will surrender services or goods in return for something in which he has no confidence. He must know that what he takes in exchange will, when tendered by him to people whose goods and services he wishes to purchase, be accepted by them. This is of even more importance now that we have banknotes and token coins as our money. These things have no intrinsic value. Their value is a matter of confidence in the Government and the banking system which is responsible for their issue, and the moment that confidence—or general acceptability—disappears, the monetary medium ceases to perform its function. It is interesting to note that when this has occurred there is an immediate fall back on the former types of monetary medium—a commodity in short supply—or to barter.

In the liberated countries at the end of the last war this did occur. During the period of occupation the currency in the occupied countries had been much debased in value, and it was obvious that once liberation had been completed a new government would be established and a new currency introduced. In order to re-establish a sound currency, only a limited amount of the new currency was substituted for the old, and balances in the hands of individuals were then made subject to investigation to deprive war-profiteers of their gains, and the substitution of new for old currency then usually took place at an exchange rate which considerably reduced the total volume of currency in circulation. With this prospect in mind people in the liberated countries were unwilling to go on giving goods and services in exchange for a currency shortly to be withdrawn, and cigarettes, coffee, tea and other commodities in short supply took the place of currency as an exchange medium. These things were for the moment more acceptable to the community, not merely for immediate consumption purposes, but also because of their exchange value for other more-wanted goods or services.

In Germany, at the moment of occupation, when confusion was even worse and there was little exchange of these commodities

between occupying troops and the civilian population, a return to barter was seen. People put up notices offering to trade specific goods in return for the things they needed.

STABILITY OF VALUE.—It is important that the medium of exchange should be something in short supply relative to its demand so that scarcity value can be maintained. The various commodities which have been used in the past have been effective for so long as they have been in limited supply and general demand, and our present currency is deliberately controlled in quantity in order to maintain its value. This was one of the main strengths of gold as a currency. It was in universal shortage and demand and served as an international currency to a large extent. Unfortunately, however, it is not possible so closely to regulate the issue and circulation of present money as to maintain a constancy of value—i.e. purchasing power. We have seen the pound sterling and most other currencies gradually losing purchasing power for many years past. It is one of the functions of the Central Bank of a country, in collaboration with the Government, to do all it can to maintain the purchasing power of money.

Money is not wanted for itself, except by the miser. It is wanted for its purchase or exchange value. We may not wish to spend all the money we receive at a given moment, and consequently we set aside some of our income to accumulate as savings. If we do this we are using money for its third purpose of storing up future purchasing power. If these savings are invested or put into a bank or savings bank account, they are made available to the Government and to industries as borrowings, and an interest is paid for the use of the funds.

THE EVOLUTION OF MONEY FORMS.—As has been said, cattle, beads, shells and commodities of various types have been used at different times and in different communities as money. All these things have an intrinsic value—a value for themselves as well as for exchange—and for so long as they were generally acceptable as an exchange medium they served their purpose as money. It is obvious, however, that the area in which they could be used was very limited. What was rare and wanted in one place and time might have been plentiful or unwanted in another place or at another time. In addition, cattle and commodities can vary in value and in quantity in relation to demand from time to time and place to place. Cattle are

not stable in value, and the value of different animals will not be the same. Nor are these things easily transportable or easily capable of being made up into large or small lots for payments of different values. For these and other reasons these items could not for long remain a satisfactory form of money nor could the area of their applicability be very extensive.

Precious metals, particularly gold and silver, soon took their place. These have an intrinsic value and can be moulded and cast into a variety of coins in quantities such that their intrinsic value and face value as coins are equal. They are also very hard-wearing, in world-wide demand and in strict limitation of supply in relation to demand. They therefore had many advantages over earlier forms of currency and soon came into wide general use.

The introduction of banknotes and token coins such as we use today was originally intended only to be a substitute for the circulation of the precious metals themselves. A bank which had one million pounds' worth of gold bullion, for example, could have this struck into one million sovereigns which could be put into circulation, or it could retain the gold in its vaults and issue one million slips of paper each representing one pound's worth of the gold in its possession. These could then circulate in place of the gold coins with much greater safety and economy, and the paper notes were promises to pay one pound on demand to any holder of the note who preferred to go to the bank and exchange it for gold. These notes were convertible, at the option of the holder, for gold held by the bank. Our £1 and 10s. notes still bear this promise but it is now invalid in that these notes have been completely inconvertible since 1931 and had been of limited convertibility since 1914.

Indeed, so far have we moved away from the conception of a gold-backed currency that virtually the whole of the present circulation of notes in this country is backed only by Government debt to, and Government securities held by, the Bank of England, only an infinitesimal part of the total issue being represented by gold bullion held to back the currency. The issue is said to be almost entirely a "Fiduciary Issue"—one based upon faith and confidence.

In these circumstances it is obvious that very careful control on the amount of currency in issue and upon the factors affecting its purchasing power is extremely important, and the Government working through the Bank of England as the Central Bank does take

measures to control the quantity of notes and coins in circulation, and also takes measures through the money market or through direct legislation to influence borrowing tendencies and spending habits when these are menacing the stability of value of the currency medium.

We are concerned with both internal and external purchasing power of our currency. Changes in the internal value of currency are referred to as inflation or deflation: inflation when the general trend of prices is to rise (i.e. money is losing purchasing power), and deflation when the general trend of prices is to fall resulting in increasing purchasing power of money.

The relative exchange value of our currency with other countries' currencies—that is to say its purchasing power abroad—may also vary, and these changes are referred to as devaluation or revaluation. Devaluation is the reduction of the value of our currency in terms of that of another country, and revaluation an increase in the value of our currency in terms of others. Since the last war we have tended to cater for external changes by direct restrictions upon our imports and exports rather than by measures designed to adjust currency exchange values to the flow of goods.

TEST PAPER

1. Name the difficulties of direct barter.
2. "Money permits our specialised effort to be turned into generalised enjoyment; we may say that each one of us is a factor in specialised production, and that the money we get entitles us to generalised consumption." Explain and elucidate.
3. Trace the evolution of money through its various stages.
4. What do you understand by a measure of value ?
5. How does our present currency measure up to the requirements of acceptability and stability of value?
6. What is the meaning of the promise on the front of a £1 note, and what is the present value of that promise?
7. What is the meaning of a "Fiduciary Issue"?

CHAPTER XXXV

Means of Payment

The remittance of money can be effected by means of coin, cheques, postal orders, money orders, bank notes, bills of exchange, promissory notes, etc. As the media through which payments are made, it will be convenient to deal with the following in the order shown on diagram on page 328.

1. The Bank of England.
2. The Mint.
3. The Post Office.
4. Joint Stock Banks.

(1) **BANK OF ENGLAND.**—This institution is responsible for the issue of Bank Notes. These are promissory notes issued by a bank payable to bearer on demand. Notes issued by the Bank of England are called *Bank Notes*, whilst those issued by Scottish and Irish banks are usually referred to as *Country Notes*. The former are legal tender for any amount, even by the Bank or its branches; that is, they are exactly on the same footing as coined money. Notes of Scottish and Irish banks are not legal tender, but they are good tender, if not objected to at the time of tender.

(2) **THE MINT.**—This is an establishment chiefly concerned with the making of coins. It is situated on Tower Hill, and is under the control of the Government. The work of the Mint may be divided as follows—

1. The coinage and issue of token silver and bronze pieces as they are required, from bullion purchased on account of the Government.

2. Minting of coinages required by British Colonies and dependencies.

3. Manufacture of naval, military, and other medals.

Bronze coins are largely minted at Birmingham; and there are also Mints at Sydney and Melbourne in Australia.

In England before 1914, the coinage (still then a gold one) was said to be "free," since there were no legal impediments to prevent an individual from having his bullion coined. It was also said to be "gratuitous," since no charge was made for coinage.

MEANS OF PAYMENT

- The State
  - Bank of England
    - Notes
      - £5, £1 and 10s. Notes — Unlimited Legal Tender
  - Mint
    - Token Coins — Limited Legal Tender
      - Silver and Cupro-nickel 40s.
      - Bronze 1s.
      - Nickel-brass Three-penny pieces 2s.
  - Post Office
    - Money Orders
    - Postal Orders
- Joint Stock Banks
  - Cheques, Bills of Exchange, Promissory Notes, Telegraphic Transfers

Money Orders, Postal Orders, Cheques, Bills of Exchange, Promissory Notes, Telegraphic Transfers — Non-legal Tender

By the terms of the Gold Standard Act, 1925, the public could not go to the Mint with their bullion; but they sold it to the Bank of England for £3 17s. 9d. per ounce, which was the Bank price of gold, and the Bank then sold it to the Mint as required for £3 17s. 10½d. per ounce; this was known as the *Mint Price* of Gold. Gold has not been used for internal circulation since 1914.

Bullion (i.e. gold or silver in bars) has been used as an international medium of settlement when other methods of payment were not available or were more expensive. These transactions were undertaken by the banks. Since 1931, however, dealings in gold have mainly been the concern of governments. Stocks of the metal have been held by Exchange Funds and Central Banks between which movements have taken place. Since the outbreak of war in 1939 the world's gold supplies have tended to become concentrated in the United States, as the great creditor nation.

(3) **THE POST OFFICE.**— With regard to the transmission of money through the agency of the Post Office, this may be effected by the purchase of postal orders or money orders.

Postal Orders. These can be obtained for 6d. and for many multiples of 6d. up to £5. Intermediate amounts may be made up by affixing postage stamps not exceeding two in number.

The sender of a postal order must fill in the name of the person to whom it is sent; and if he so wishes, he can also fill in the name of any particular post office, when the order will be cashed at that office and no other. The insertion of the name of the paying office affords a safeguard against payment being made to a wrong person. A postal order may be crossed like a money order or a cheque. The sender retains the counterfoil, as its production will facilitate inquiry if the order should be lost.

Inland Money Orders. An inland money order may be obtained for any sum not comprising a fractional part of a penny, up to £50; for transmission abroad, the maximum limits vary from £10 to £40. If payable in the United Kingdom, an order may be crossed for payment through a bank. Orders for sums up to £50 may also be transmitted by telegraph to offices within the United Kingdom.

A poundage (a charge varying with the value of the order) is made for both postal and money orders.

Foreign and Colonial Money Orders, both ordinary and telegraphic, are also issued for transmission to and payment in almost all the

British Colonies and in foreign countries. For further particulars upon this subject, the student is recommended to obtain the *Post Office Guide*, which is issued quarterly, and which contains a mass of information of great use to the business man.

(4) **JOINT STOCK BANKS.**—The economic significance of banks is based upon the fact that they are the chief medium through which payments are made and credit is brought into existence. By their agency, the money and available capital in a community are collected and then directed into the produce channels of industry. The primary function fulfilled by banks, however, is the regulation and simplification of the whole system by which payments are made and debts are settled. This is effected by the use of the following—

Cheques. These have come into use in consequence of the development of the deposit business, and are orders to pay to the depositors or their order; whilst bank notes are promises on the part of the banker to pay to the bearer. The vast majority of accounts are paid by means of cheques.

Bills of Exchange. These are the chief means of settling international indebtedness. They can be made payable to a specific person or his order, and are usually payable at a determined interval of time after their emission. During their currency they may be passed from hand to hand, the person holding the bill at its date of maturity collecting from the original debtor, the intervening debts having been cancelled out by the passage of the bill.

Traders' Payments. Under this scheme the customer gives to the bank a list of the persons to whom he wishes payment to be made, showing the names of their bankers, the branch where the account is kept, and the amount he wishes to pay to each. A cheque is drawn covering the total amount as shown on the list. The banker then transfers these amounts to the banks named and debits the account of its customer. This system combines economy with a high degree of safety.

Telegraphic Transfers. Beside the accounts settled by cheques and bills of exchange, there is also a system of Telegraphic Transfers, or Cable Transfers as they are often called, which is a daily rate quoted in the money market for transferring money by cable from one country to another. For example, if a person in London wished to pay a certain number of rupees to a firm in Calcutta on any particular date, he might pay into a London bank the

equivalent sum of English money, calculated at the transfer rate of the day, when the bank would cable out to their Calcutta branch to pay the nominee the sum required.

LEGAL TENDER.—This is any form of money which can be used as a legal quittance of a debt, and which cannot be refused by the creditor. In the British Isles, for instance, no one can be compelled to accept more than £2 in silver or one shilling in pennies or halfpennies, in satisfaction of a debt; consequently, it is said that silver is not legal tender for sums exceeding 40s.

Token Money. This refers to that form of money which circulates at a value given it by the Government which is higher than that of the metal contained in it. A "silver" shilling (actually now made of cupro-nickel), if melted down, is worth less as bullion than as a coin. Token coins are made to circulate at their nominal value by restricting their issue to meet existing needs.

THE TREASURY.—The Treasury is a department of the Government, and is responsible for the issue of Treasury Bills and Exchequer Bonds.

Treasury Bills are issued in return for sums of money lent to the Government by private individuals. When the Treasury is in want of money to meet the current expenses, an advertisement is usually inserted in the *Gazette* requesting that tenders up to a certain amount be sent in to the Bank of England by a specified date; and parties having capital at their command, and being satisfied with a low rate of interest, offer to lend the Government a stated amount, and name the rate of discount they will accept. For instance, if a person offered the Treasury £100 at 4 per cent discount, he would lend only £96, but would receive a Treasury Bill for £100. The device of the Treasury Bill was originally intended to bridge seasonal discrepancies between Government revenue and expenditure, but the Great War of 1914–18 was responsible for its growth to large dimensions. The Treasury also issues Exchequer Bonds, which carry interest at a stated rate, are repayable at fixed dates, and are payable to bearer, e.g. "5 per cent Exchequer Bonds, redeemable 5th October, 1960."

Treasury Deposit Receipts first appeared during the Second World War. They were loans in units of £500,000 made by the banks direct to the Treasury and repayable in six months. The rate of interest on T.D.R.'s was slightly higher than that on Treasury Bills. It was

possible for a bank to sell its T.D.R.'s to the Bank of England if it was short of cash, but this was done only in cases of emergency. Their issue has now been discontinued.

Government borrowing falls under two heads—the Funded Debt, comprising permanent loans, such as Consols, and the Unfunded Debt which consists of those obligations for which a time of repayment has been stated. The Unfunded Debt includes the War Loans, some of which are repayable in a number of years, and the above-mentioned Treasury Bills and Exchequer Bonds. Owing to the magnitude of its financial operations the Treasury now exerts a considerable influence on the Money Market.

TEST PAPER

1. Enumerate the chief media through which payments are made.
2. Copy the diagram on page 328 and name any methods of payment which are not stated thereon.
3. Explain the difference between a Money Order and a Postal Order?
4. Account for the popularity of cheques as a means of remittance as compared with bank notes.
5. Explain the use of Telegraphic Transfers.
6. Describe the chief operations which are performed by the Mint.
7. What is the meaning of Legal Tender? Is a limitation of the legal tender of *token coins* necessary to keep up their parity value?
8. Distinguish between Treasury Bills and Exchequer Bonds.
9. Enumerate the chief advantages and disadvantages of the use of £1 notes.
10. What are the differences between (*a*) a cheque, (*b*) a bill of exchange? What considerations determine which shall be selected as a means of paying a debt?
11. Explain in what respects the specialised bill of exchange, called a cheque, differs from the ordinary commercial bill of exchange.
12. You owe a customer in Glasgow £23 17s. and another in Rotterdam £145. Describe the usual methods of paying these accounts.
13. A London merchant who has no banking account wishes to send £5 10s. to a Manchester merchant in settlement of an account. By what means could he send the money? Which means would you recommend and why?
14. Describe briefly the facilities offered by the Post Office for the discharge of indebtedness between persons in one business centre and in another in this country. Do they possess any advantages over those afforded by the banks?

CHAPTER XXXVI

CENTRAL BANKING

IMPORTANCE OF BANKING.—Banking and financial considerations are of paramount importance in the working of the economic system. Modern industry is engaged in the production of utilities for the benefit of the consumer, but as we have already seen in examining some of the many channels of distribution, producer and consumer are often widely separated both in space and in time. It is an outstanding characteristic of the modern economic system that production is undertaken in *anticipation* of demand, so that the income from the sale of goods to the consumer may not be realised for some considerable time. But the income derived from the sale of the goods represents the source from which payment is made to all those who have participated in production, and many of these cannot or are unwilling to wait until payment is received from the ultimate consumer. The electrical engineering firm which builds generating plant for a power station in South America has to pay wages and salaries to its staff in the course of the work; it has to meet bills for material from its trade suppliers, and pay a variety of indirect expenses. Moreover, even when the equipment is complete and erected, it by no means follows that payment will be received immediately.

From this statement it will be seen that there is a gap to be bridged between the paying away of liquid resources in the form of money and the receipt of funds in payment for what has been produced. This gap may, of course, be filled from the resources of the business house itself, since, as we have seen, a certain margin of working capital (some part of which must be held in the form of cash) is indispensable. Yet it may well happen, particularly when operations are conducted upon an extensive scale, that the resources of the individual business are not nearly sufficient to meet the calls which are being made upon them. Moreover in many cases, the settlement of the financial side of the transaction may be by no means straightforward as in the case of foreign trade, where differences of currencies and exchange intervene. There is obvious scope for the introduction of specialised institutions to

assist in the bridging of this gap, and herein lies the function of the banking and credit system. It provides an agency for the supply of capital to business men and also a channel for the distribution of the various forms of currency utilised by the economic system of the country concerned.

The efficiency with which this task is discharged has considerable economic and social significance. As Lavington points out in his work, *The English Capital Market*: "It is evidently possible for individual producers to concentrate their energies on the output of a single kind of service or product only in so far as means are provided by which these products may be quickly and conveniently exchanged by way of purchase and sale; their specialisation is limited by the efficiency of the money system—by the ease and safety with which the community can make the payments by means of which these products are redistributed." Anything which adds to the efficiency of the banking system is therefore of direct benefit to the commercial community, whereas if the system fails to adapt itself to its economic environment, considerable injury to the whole economic structure may swiftly follow.

NATURE OF A CENTRAL BANK.—In view of the importance of finance in modern life, it may well be asked whether it is desirable that the provision of financial facilities should be left in the hands of private institutions. In recent years, many people have considered that such an important function should be directly controlled by the State, with the result that in 1946 the Bank of England was nationalised. In the past, when money as a physical medium of exchange constituted the principal means of settlement of debts, the State assumed the sole rights of issue in all developed countries. Under modern conditions, however, although such State-issued money is still of importance, a far greater volume of indebtedness is settled by the use of non-legal tender currency which is created by the banks. It might therefore seem legitimate to argue that if State control is justified in the one case, it is equally necessary in the other.

Bitter experience has shown, however, that an unfettered interference of the State in currency affairs can create abuses far worse than those which it is designed to prevent. The question arises: Is it possible to evolve some system which shall confer an effective control over the financial institutions of a country and at the same

time be free from political interference or the pressure of sectional interests? In most commercially developed countries the solution has been found in the creation of a specialised financial institution known as a central bank. *A Central Bank* may be defined as the principal banking institution of a country, operating under some degree of State control, and charged with the duty of regulating the volume of money and credit in the interests of the community as a whole. The objective test of the success of this policy is usually taken to be the degree of stability of value shown by the national monetary unit.

As a public institution charged with special responsibilities, a central bank must look further than the interests of its shareholders. In the course of its duties, not only may it have to refrain from making a profit on many of its transactions, but it may have to incur deliberate losses if it is to the public interest to do so. Again, a central bank may often have to take action in the face of public opinion and should be sufficiently strong to do so without danger of interference. Thus, the restriction of credit which may be necessary in order to curb unsound developments in boom periods will invariably provoke an outcry from the commercial world. At the same time, however, the central bank must preserve the closest contact with the needs of commerce and industry, and this liaison may be in part effected by a judicious selection of directors. So far as the Bank of England is concerned, its directors are selected on the basis of their power to bring to the Court information and knowledge as to what is proceeding in various spheres of economic activity, both in respect of domestic industry and with regard to foreign trade. No one is selected specifically as a representative of any particular industrial interest.

FUNCTIONS OF A CENTRAL BANK.—As already indicated, the principal responsibility of the modern central bank is, through the control of currency and credit, to maintain national economic equilibrium. From an historical standpoint, the principles of central banking were established empirically long before they received theoretical formulation. The Bank of England has been the great pioneer of central banking, but it assumed its responsibilities slowly and grudgingly. Since the first World War there has been a continuous development in the number of such institutions, although the scope of their authority varies greatly from one country to

another. In the discharge of their basic function, central banks cannot hope to have the power to govern and direct all the factors influencing national economic equilibrium; they merely discharge an essential mediatory and regulatory function in the economic organisation. Although the precise functions of different central banks vary, the following are generally recognised as being the most essential—

(1) **Control of the Note Issue.** If the central bank is to assume responsibility for maintaining the stability of value of the national monetary unit, it must exercise the power of control over the conditions of its issue. In the majority of countries, the principal monetary unit now takes the form of a paper note which may or may not be linked with gold, so that the central bank should possess a monopoly of note issue under conditions laid down by the State. This also ensures that monetary policy shall be in some measure free from political control, for although it is competent for a Government to revise the regulations regarding note issues, this will have to be done openly, thereby giving an opportunity for an expression of public opinion in the matter. Thus the Bank of England has a monopoly of note issue in England and Wales under the Currency and Bank Notes Act, 1928, which is discussed below. Similar forms of legislation have been introduced in most economically developed countries.

(2) **Control of Gold Reserves.** The central bank must hold and deal with the country's gold reserves. Since these have been largely withdrawn from the function of bolstering the internal value of the currency, they have been largely held in earmarked funds for the purpose of maintaining the external value of the currency and the country's balance of payments position with other countries.

(3) **Control of Credit.** The foregoing functions are concerned mainly with the control of the legal tender currency; but, as already indicated, under modern conditions, by far the greater volume of transactions are settled by means of non-legal tender currency, mainly in the form of cheques. A cheque, in effect, operates to transfer the ownership of a certain amount of wealth in the form of a bank deposit from debtor to creditor. These bank deposits may be created either by customers who deposit funds with the bank or by the willingness of the bank itself to grant advances by way of loans or overdrafts to customers at an agreed rate of interest. The

effect of these loans and overdrafts on the financial system is exactly the same as an increase in the note issue, except that they cannot be controlled directly by the Central Bank. Indirect control is obtained in several ways, one of them the Bank Rate, which governs all other loan and interest rates in the market. Thus, if it is desired to check the extension of credit, Bank Rate is raised and all other rates of interest tend to rise in sympathy, with the result that the cost of borrowing from the banks is increased and the desire of customers to borrow is checked. This control of credit, which will be discussed more fully later, is one of the most important functions of a modern central bank.

(4) Acting as Government Banker. As already indicated, the relations of a central bank to the State are of a peculiar nature on account of the public importance of the functions which such a bank discharges. The ties between the central bank and the State are further strengthened by reason of the fact that it is now imperative that the bank should conduct the financial operations of the Government. The financial operations of the modern State, both on revenue and capital account, have now assumed such dimensions that, were they conducted independently of the central bank, the resultant disturbances of credit would render its task of maintaining monetary and credit stability impossible. If, however, the control of these operations is vested in the central bank, it can take all the measures which it deems necessary to minimise their effects on ordinary business activity.

(5) Relations with the Commercial Banks. In order that Government policies regarding the direction of the country's economy may be effectively carried out there must be close co-operation between the central bank and the commercial banks. Thus, when it is considered advisable to restrict the creation of credit the central bank will advise the commercial banks upon the lending policies which they should adopt. In addition, in this country, the commercial banks which are members of the London Clearing House keep accounts with the Bank of England upon which balances arising from cheque clearings are adjusted.

(6) Co-operation with Other Central Banks. For the settlement of international debts the central banks work in conjunction with one another to effect the "clearing" of differences in debts between nations in somewhat the same way as home clearings are effected.

The central banks are also usually responsible for holding and administering the gold reserves which are held for this settlement of international debts through the machinery of the International Monetary Fund, the European Payments Union and other such organisations.

I. THE BANK OF ENGLAND.—The connecting link between the Italian system of banking and modern banking is that of the goldsmiths in the seventeenth century. At that time, they were the only people who could keep valuable property safe, so that they took in the property of their customers in the form of precious metal, plate, and coin. In return for these values, they granted their customers—

(1) The right to payment in cash.

(2) The direct payment to a third person by what was called a cash loan, but what is now called a cheque.

(3) The right to a general payment from the goldsmith to pay (on demand) anybody who presented that general payment. The document was known as a goldsmith's note, and was similar to our present bank note.

During the reign of William III, when England was divided between Whigs and Tories, the country was in danger of the Stuart Pretender coming back to the throne. William III stood as the leader of the Whig party, which consisted chiefly of dissenters or Nonconformists. These Nonconformist Whigs were in danger of the Episcopalian or Roman Catholic, or Stuart, interest prevailing, for, if it had prevailed, the merchants of London—who were Whig—felt that their interests would be jeopardised. Hence, what the Government of William III most wanted were the sinews of war in the shape of money. This state of affairs led to the establishment of the Bank of England in 1694. The sum of £1,200,000 was raised by a Scotsman named William Paterson and others, and was lent to the Government at 8 per cent interest, together with £4,000 for management. The original subscribers to that loan were granted a charter, and were known by the title of the "Governor and Company of the Bank of England," and even to this day that is the full title of the Bank of England.

Banks were afterwards started all over the country, and were in the habit of issuing large quantities of notes, although there

were many failures. In consequence of the great services rendered by the Bank of England to the Government at various times, its charter was renewed again and again.

In 1797, however, the Bank passed through its greatest crisis. It had been overstrained to finance the Great Napoleonic Wars. Pitt was continually promising not to borrow more from the Bank, but repeatedly broke his promise until, on the 25th February, 1797, the Bank of England was obliged to suspend cash payments. Owing to the depletion of the Bank's reserve on account of the assistance given to the Government, there was nothing left for it but to ask for protection. It therefore obtained from the Privy Council an order forbidding it to pay its notes in gold until further notice. This order was submitted to Parliament and confirmed. This commenced the period of Bank Restriction.

BANK RESTRICTION ACT, 1797–1819.—The Bank Restriction Act was passed on the 3rd May, 1797, and by its terms the Bank of England was forbidden to make its payments in cash. Payment in notes was to be deemed payment in cash. The notes were to be taken at par and could be used in the payment of taxes. Notes could also be issued at a low denomination, and the Act was to remain in force for little more than a year, although it was renewed again and again.

In 1800, owing to the exchanges being very much against England, it was still considered dangerous to pay in cash—the gold being required for export. At that time it began to dawn upon many people that something must be wrong, since the market price of bullion—as measured in notes—was very much above the Mint Price. In consequence, two theories were proposed—

(1) That the notes had declined in value;

(2) That the notes had risen in value.

These two theories were so greatly opposed to one another, that they were referred to a Committee of the House of Commons, which was known as the *Bullion Committee* of 1810. To that committee was committed seven issues. They had three facts placed before them, and they were asked four questions.

1. The market price of bullion was £4 10s. per ounce.

2. Exchanges were far below par. The Paris Exchange was 14 per cent below par (i.e. the gold sovereign would buy only 21·8892 frs. instead of 25·22 frs.).

3. The notes were increasing and the specie was vanishing. The four questions asked were—

(1) Are notes depreciating or appreciating ?

(2) Has the increased issue any effect on the foreign exchange ?

(3) What effect would a restriction of the issue have on the price of gold and on the foreign exchanges ?

(4) How should note issues be regulated ?

Generally speaking, the Committee answered these questions by admitting the truth of the *three* facts submitted, and gave the respective replies to the questions as follows—

(1) The notes were depreciated.

(2) Yes ; the increased issues, when excessive, set the exchanges against us.

(3) It would raise the value of the currency, bring exchanges to par, and restore gold into circulation.

(4) The answer to this question was " by reference to the foreign exchanges and the price of bullion." The close watching of the movements of the foreign exchanges and the price of notes would indicate what should be done.

The Report of the Bullion Committee had to be submitted to the House of Commons. When it was moved, the resolutions were all thrown out ; and, in the presence of a price of bullion of £4 10s. per ounce, the House resolved that notes were held in public estimation as equivalent to legal coin.

Naturally, things went from bad to worse. After the rejection of the Bullion Committee Report, it was not long before the price of gold reached £5 per ounce. Then followed a serious succession of bad harvests, succeeded by good ones. The bad harvests ruined the farmers and the ruined farmers ruined the country banks, whilst these latter withdrew vast quantities of notes out of circulation. Hence, the Bank notes were no longer in excess of the people's wants, and thus recovered their value. Peel then saw his opportunity, and in 1819 he brought in the Bill for the Restoration of Cash Payments.

From 1819 to 1844 was a period of much theoretical discussion in connection with banking, being characterised by the rise of the contest between the Banking and Currency Schools. On the one hand, the Currency doctrine, supported by Lord Overstone and other influential persons, held that it was necessary to regulate

the issue of convertible notes by law; on the other hand, there was a considerable number of persons who believed in the prevailing Banking principle, and argued that, if the bank note was always convertible, its regulation could be left to the safety of the bankers, who would take care not to issue notes which they could not pay. Finally, the Currency School was triumphant, and its success was crystallised in the Bank Charter Act of 1844.

BANK CHARTER ACT OF 1844.—Since its foundation in 1694, gradual changes have been wrought in the constitution of the Bank of England. The five main provisions of the Bank Charter Act of 1844, whereby its various privileges were ratified and consolidated, were—

(1) The establishment of the Issue Department.

(2) Anyone could take gold to the Issue Department and receive notes at the rate of £3 17s. 9d. per standard ounce.

(3) The Bank was allowed to issue fiduciary notes to the extent of £14,000,000, on placing securities in the hands of the Issue Department. For notes issued beyond that amount, gold or silver bullion had to be kept by the Issue Department for a corresponding amount.

(4) The bank note could not be issued for a smaller sum than £5.

(5) The Bank of England was called upon to publish a weekly statement, which appears in the next succeeding *London Gazette*, and is quoted in all the chief newspapers after its issue on Thursdays.

Thus, by this Act the Issue and Banking Departments of the Bank of England were completely separated. The Issue Department could not issue any notes beyond £14,000,000 in value, unless it had an equivalent in gold or bullion for the amount of such excess. But in case a bank having the power to issue notes should relinquish the right to issue, the Issue Department of the Bank of England could increase its issue to the extent of two-thirds of the issue relinquished. Moreover, if any bank ceased to issue notes, it could not afterwards claim the right to issue; and any bank not having the right to issue notes at the time the Act was passed, could not, in the future, acquire the right to issue notes.

One of the chief purposes of the Bank Charter Act was the mitigation of crises by preventing the inflation of the currency.

The Bank endeavoured to meet subsequent crises, not by the power of the Act, but by its suspension. This method, however, has proved useless. Four times the Bank Charter Act had been suspended, viz. in 1847, 1857, 1866 and 1914.

In the last-mentioned year Treasury notes were issued on the credit of Government against the taxes of the British people.

FUNCTIONS OF THE BANK OF ENGLAND.—Under the Bank of England Charter, 1946, the Bank is governed by a Governor, a Deputy-Governor, and sixteen directors. When a director has given several intermittent periods of service, he generally attains tenure of office for life. In due rotation he may become Deputy-Governor for two years and then Governor. From 1920 to 1944 Lord Norman held the Governorship and was followed by Lord Catto. In March, 1949, Mr. C. F. Cobbold became Governor. The Governor is held responsible for seeing that the securities held for investment by the Bank are of the first class. In this matter he is assisted by the Treasury Committee.

The Bank of England is now a State-owned bank, the main function of which is to give union and direction to the flow of credit facilities. In some of its operations it resembles other national banks, such as the Bank of France and the German Reichsbank.

The actual functions of the Bank of England may be briefly stated thus—

(1) **To Manage the Note Issue.** Since 1921 the privilege of issuing notes has been withdrawn from all other banks in England and Wales. As the Bank of England enjoys the sole right of note issue, it has the power of control over the issue of the national monetary unit.

(2) **To Safeguard the Ultimate Reserve of Gold in England.** The Bank of England is responsible for the custody of the central gold reserves of the country. These reserves are now largely earmarked for the settlement of international indebtedness.

(3) **To Act as the Bankers' Bank.** The Bank of England has become the depository of cash reserves of the joint-stock banks. They are, therefore, customers of the Bank, although they receive no interest on their deposits.

(4) **To Act as a Clearing Agent.** The Bank of England acts as a clearing agent for the settlement of differences between the various banks. In this capacity it is able by mere book entries to settle

the differences which arise from day to day between these banks. Unless some such arrangement existed, the banks in question would be under the necessity of holding vast sums of currency for the purpose of meeting their respective obligations to one another. Thus the Bank of England is the ultimate adjuster of debits and credits, receipts and payments, which are effected through the Clearing House.

(5) **To Conduct the Main Banking Business of the State.** The State is the collector of vast sums of money from the community in the form of taxation—Customs, Excise, Income Tax, and various other sources. All these are paid into the Government's account at the Bank of England. The Bank also looks after the payment of interest and dividends to investors in Government securities whose names are registered in its books.

(6) **To Transact the Ordinary Business of Banking,** which may be subdivided into—

(*a*) The private drawing office, which keeps all accounts except those of the Government.

(*b*) The public drawing office, which keeps the accounts of the various departments of the State.

(*c*) The maintenance of branches (nine in number) for the expeditious payment of taxes to the credit of the Exchequer. These branches are established at seaport towns, such as Liverpool, Plymouth, Newcastle, Hull, and Bristol, where import duties are received.

The chief sources of profit of the Bank of England arise out of the discounting of bills, interest on loans, allowance for managing the National Debt, etc.

LIMITATIONS OF THE BANK OF ENGLAND.—There are, on the other hand, certain limitations imposed upon the Bank of England, two of which may be specially mentioned, viz.—

(1) **To Maintain Its Assets in a Liquid Form.** The liabilities of the Bank of England are largely payable on demand. It is essential, therefore, that it should maintain its assets in the most liquid form possible. Its business is to provide that the ordinary commercial trading banks of the country should have a sufficiency of credit available to form the basis of the amounts of credit that they may find it necessary to create to meet the varying demands of their customers.

(2) **To Act in the Interest of the Community as a Whole.** Since March,

1946, the stock of the Bank of England has been held by the Treasury and not by stockholders. As a national bank, it should not be under the necessity of having to assure itself of earning profits out of all the business it does. It should be free from the care of having to order its operations from the point of view of earning profit. For this reason it is usually agreed that the Bank of England should not pay interest on its deposits.

Thus the primary duty of the Bank of England is to the community as a whole. Although it has duties to the Government since it is the banker of the Government, its duties in that respect are the ordinary duties of banker to customer. Being a national bank, the Bank of England should be free from political pressure and should not be required to subordinate sound finance to the dictates of political expediency.

THE BANK RATE.—The Bank Rate is the official minimum rate per cent of discount charged by the Bank of England for discounting first-class bills of exchange. It is regulated weekly according to the demand for advances and the amount of reserve in the Bank. Except for a short period at the beginning of the war, Bank Rate remained fixed from 1932 at 2 per cent for some 20 years. In recent years it has risen and at the beginning of 1960 stood at 5 per cent. The movements of the Bank Rate are closely connected with the general rate of discount charged by other bankers, the explanation of which is based upon a proper understanding of the "deposit rate." For example, suppose the Bank of England were to raise its ordinary discount rate. This means that other banks desirous of receiving deposits would have to offer a larger deposit rate. Since these banks would have to pay a higher rate for deposits, they therefore charge a higher rate for the amount lent to the bill-brokers. In self-defence, the bill-brokers are compelled to raise their rate of discount to the public, whose bills they negotiate. Hence the Bank of England, by raising its discount rate, starts a rise which tends to find its way everywhere else in the country.

The following effects may follow from a rise in the Bank Rate. In present-day conditions, however, other measures of control are usually introduced with Bank Rate changes to bring about these effects.

(1) *The Deposit Rate of the Joint-stock Banks is Increased when the Bank of England Raises its Discount Rate.* The joint-stock

banks who receive money on deposit automatically raise the deposit interest rate in order that their customers may continue to maintain their deposits.

(2) *The Market Loan and Discount Rates become Dearer following on the Raising of the Deposit Rate.* The joint-stock banks have to pay more for their money, and consequently they in turn must charge a higher rate of interest for the loans they make and for discounting bills.

(3) *Credit is Restricted and Speculation Discouraged.* As the rates of interest on loans have increased, it is but natural for borrowers to make every endeavour to reduce their interest charges by reducing their loans. In order to find the money to pay off the loans, firms are compelled to allow their customers less credit than formerly, thus resulting in a general restriction of credit. Similarly, speculators often buy and sell shares with the aid of large loans from the Bank. On an increased loan rate they find that it becomes increasingly difficult to make their "turn" sufficiently large, and in consequence they liquidate the stock they may be carrying and thus there is a downward tendency in the share market.

(4) *Gilt-edged Securities become Cheaper.* The increase in the deposit rates may show that money on deposit is a more remunerative source of income than dividends and interest on Government stocks. Hence there is a tendency for the price of gilt-edged securities to fall until the yield thereon comes into line with the interest on deposits.

(5) *Prices may Fall.* When money is cheap, manufacturers are often in possession of large stocks which are sometimes held on credit against a bank loan. The rise of the loan rate results in an additional burden which the manufacturers find themselves unable to bear. Thus they may liquidate their stocks, thereby creating a fall in prices.

(6) *Imports are Discouraged and Exports Encouraged.* With the fall in prices, foreign markets may prove more attractive than home markets and there may be an increase in the export trade. Conversely, materials will be cheaper in England than elsewhere, and to this extent imports may decrease.

(7) *There is an Increased Demand for Short-dated Remittances and Trade Bills on London.* Following on the increase in the export trade, a greater number of foreign debtors will be buying trade bills on London for the purpose of settling their indebtedness.

BANK OF ENGLAND

RETURN FOR WEEK ENDED WEDNESDAY, 23rd January, 1957

Issue Department

	£		£
Notes Issued—		Government Debt	11,015,100
In Circulation	1,867,343,584	Other Government Securities	1,910,173,640
In Banking Department	58,014,678	Other Securities	801,066
		Coin (other than Gold)	3,010,194
		Amount of Fiduciary Issue	1,925,000,000
		Gold Coin and Bullion (at 249s. per fine oz.)	358,262
	£1,925,358,262		£1,925,358,262

Banking Department

	£		£
Capital	14,553,000	Government Securities	200,456,629
Rest	3,775,062	Other Securities—	
Public Deposits*	14,779,018	Discounts and Advances	39,691,750
Other Deposits—		Securities	17,700,606
Bankers	212,875,329	Notes	58,014,678
Other Accounts	71,833,591	Coin	1,952,337
	£317,816,000		£317,816,000

*Including Exchequer, Savings Banks, Commissioners of National Debt and Dividend Accounts.

(8) *Exchange Becomes Favourable.* As a result of the demand for sterling bills from foreign countries, sterling following the law of supply and demand will tend to become dearer, or, in other words, more favourable to us.

OPEN MARKET POLICY—In recent years the Bank has not made use of Bank Rate alone, but has pursued an "open market policy." By buying Treasury Bills and Government stocks in the Stock Exchange or Discount Market, the Bank of England increases the balances of the ordinary banks. The banks are then anxious to invest or lend out their surplus cash in order to increase their profits. The demand for bills of exchange and gilt-edged securities by the banks causes a rise in their price and there is a fall in the rates of discount charged by the Discount Houses. The effect, therefore, of "open market policy" has been to make money cheaper. If the Bank of England had sold Treasury Bills to the market instead of buying them, money would have been dearer.

BANK OF ENGLAND RETURN.—This return, which has been termed the " Barometer of the Money Market," is issued by the Bank every week, and gives a significant indication of the state of monetary conditions generally. The following brief notes explain the significance of the various items—

Issue Department. On the liabilities side of the Issue Department, the items are—

"*Notes Issued—in circulation*, £1,867,343,584." It will be seen from the specimen return that the total amount of "Notes Issued" is £1,925,358,262.

"*Notes Issued—In Banking Department*, £58,014,678." This item represents the actual amount of notes held by the Bank itself, as shown on the assets side of the Banking Department.

At the date of this return the total of notes in circulation would still be a little inflated by reason of extra Christmas demand for notes.

The assets held in the Issue Department against the total notes issued consist of—

"*Government Debt*, £11,015,100." This is the debt owing by the Government to the Bank, and is not represented by either stock or securities. At the original foundation of the Bank, it was stipulated that £1,200,000 should be lent to the Government, and this has gradually increased up to the above figure. The amount has remained unchanged since 1833.

"Other Government Securities, £1,910,173,640." This figure represents part of the paper " backing " behind the fiduciary issue, and in all probability consists of Treasury Bills.

"Other Securities, £801,066." These are all British securities, such as Commercial Bills, Consols, etc., which the Bank was permitted to hold under the provisions of the Bank Charter Act, 1844.

"Coin (other than Gold), £3,010,194." The Bank may now hold silver coin to an amount not exceeding £5,500,000 as security for the Fiduciary Issue. It must be noted that this does not constitute part of the metallic backing of the note issue. The foregoing items on the assets side of the Issue Department together make up the £1,925 millions which represents the fixed amount of notes known as the *Fiduciary Issue* which the Bank is legally empowered to issue without a gold backing.

On the basis of the Currency and Bank Notes Act, 1928, the Fiduciary Issue of the Bank of England was raised from £19¾ million to £260 million and could temporarily be increased at the instance of the Bank of England with subsequent sanction by Parliament. This raising or lowering of the Fiduciary Issue, together with the operations of the Exchange Equalisation Account, must now be considered as forming a part of the technique of a "managed" currency. Thus, on 6th January, 1939, the Bank of England sold £200 million worth of gold to the Exchange Equalisation Account, which needed strengthening, since it had suffered heavy drains of gold during the preceding year. The effect of the sale was to diminish the gold reserve of the Bank of England from £326 million to £126 million. In the circumstances this would have necessitated a heavy decrease in the issue of notes unless the Fiduciary Issue was raised. It then stood at £230 million and was forthwith increased to £400 million. The Currency and Bank Notes Act, 1939, reduced the Fiduciary Issue to £300 million, thus amending the Act of 1928. During the war the Fiduciary Issue was raised on numerous occasions and in December, 1946, it reached a maximum of £1,450 millions. It was subsequently reduced to £1,300 millions, but continued inflation since has forced the figure up further.

"Gold Coin and Bullion, £358,262." This figure gives the amount of Gold Coin and Bullion held in the vaults of the Bank as a cash reserve against its circulation of notes.

The Banking Department. Taking the Liabilities side of the Banking Department, the items are—

"*Capital*, £14,553.000." This consists of the amounts which were subscribed from time to time by the shareholders and invested in the undertaking. The original capital of the Bank was £1,200,000. Hence it will be seen there has been a considerable increase since the foundation of the Bank.

"*Rest*, £3,775,062" This item is rather a curiosity in the banking world, since it represents what the other banks call a Reserve Fund. It simply means " surplus " and, like the reserve fund of a joint-stock bank, represents an accumulation of undivided profits maintained to meet contingencies. Unlike other ordinary bank reserves, the " Rest " does not remain at a fixed level, but it fluctuates every week. It includes the balance of the Bank's profit and loss account, out of which its dividends are paid from time to time, but the total of the " Rest " is never permitted to fall below £3 million.

"*Public Deposits*, £14,779,018." This liability item represents sums standing to the credit of various Government Departments. Among the figures contained therein are the National Exchequer Balances, Savings Banks Deposits, Deposits by the Commissioners of the National Debt, and sums held for the payment of dividends on Government and other Stocks. The figures increase very rapidly during the first half of the year, when the income and other taxes are being paid.

"*Other Deposits*, £284,708,920." This total is now separated into " Bankers " and " Other Accounts." Bankers' Balances constitute the largest part of the item and represent that portion of the cash balances of the outside banks left with the central bank. The item "Other Deposits" includes the balances of the large joint-stock banks as well as the Foreign and Colonial Government balances. All the clearing bankers keep a balance with the Bank of England, which forms a kind of cash reserve, which can be drawn upon in case of need. It is interesting to note that the Bank allows no interest upon these deposits.

A rough inference may be drawn that, when the amount of "Bankers' Deposits" is very large, money is plentiful. It implies that the joint-stock banks have a large amount of " Cash in Hand " (i.e. to their credit) at the Bank of England. The balance included among the "Bankers' Deposits" is equivalent to cash in hand, so that

it forms the first line of defence in the case of the other banks. Consequently, when the item "Bankers' Deposits" rises above a certain level, it is expected that money will be " cheap."

On the opposite side are the Assets. These are—

"Government Securities, £200,456,629." This includes the Bank's investments in British Government Stocks and in Treasury Bills, in addition to its Loans to the Government on " Ways and Means Advances " and " Deficiency Bills," both of which are methods of borrowing resorted to by Government Departments to tide over temporary shortages pending the receipt of tax payments.

On the payment of dividends on the Government Stocks, warrants are issued by the Bank, and these are paid by their recipients into the various joint-stock and other banks—only to find their way again into the Bank of England as " Other Deposits."

"Other Securities, £57,392,356." This is separated into " Discounts and Advances " and " Securities," and represents the investments of the Bank in other than Government Securities, together with discount and loans to the money market.

When the Directors of the Bank of England come to the conclusion that money is too abundant and discount rates are too low, they decrease the amount of the securities which the Bank holds —either Government or other securities. This is effected either by selling securities or borrowing on the securities. The person buying the securities or making the loan to the Bank takes over the securities and, in return, pays over a cheque into the Bank of England. Under these circumstances, when the Bank borrows, there follows a decrease in the " Government Securities " or " Other Securities " and also in " Other Deposits."

"Notes, £58,014,678"—"Coin, £1,952,337." The total of these two amounts makes up what is known as the " Reserve " of the Bank. Prior to the Second World War when Bank Rate policy was in operation, this item was anxiously watched in financial circles. The amount of the "Reserve" from week to week played an important part in deciding whether the Bank would increase or reduce its rate of discount. If the Reserve decreased to the extent of two or three millions below the average amount, the rate would almost certainly be increased in the following week. If the Reserve was increased by such a sum above its average, the rate, if a high one,

was generally reduced. A great deal depended, however, upon the period of the year, because money in the first half of the year was generally in greater abundance than it was during the second half, when the rate of discount was usually about 15s. or £1 per cent more than in the first six months of the year. The Bank of England always has to consider whether the amount of its holding of "Reserve" is sufficient, not only for its own liabilities, but also for the liabilities of all the other banks and for the amount of credit which is being given by the whole banking community. Thus, according to the figures in the Return set out on page 346, it will be seen that the Bank is liable in respect of Public Deposits and Other Deposits to the extent of £299,487,938; against this, the Banking Department holds Notes and Coin to the value of £59,967,015. Hence it will be seen that the "Proportion" of the reserve to its liabilities amounts to about 20 per cent.

THE INTERNATIONAL MONETARY FUND.—The establishment of this Fund was recommended by the United Nations Monetary and Financial Conference held in Bretton Woods in July, 1944. The purpose of the Fund is to promote international monetary co-operation, facilitate the expansion and balanced growth of international trade and promote exchange stability. Each of the forty-six members has been assigned a quota which is expressed in United States dollars and must pay in gold either 25 per cent of its quota, or 10 per cent of its gold holdings, whichever is the smaller, plus the remainder in its own currency. The quota for the United Kingdom is $1,300 million and that of the United States is $2,750 million. In 1946, the par values for the currencies of thirty-two members were published by the Fund, and it was ruled that any changes in these rates should only be made to correct fundamental disturbances in exchange values, and with the consent of the International Monetary Fund. Through the Fund member countries may purchase other currencies to settle indebtedness. Most of these purchases have been of dollar currency.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT.—This Bank was recommended by the Conference at Bretton Woods in 1944 and the Articles of Agreement were signed in Washington in December, 1945. The purposes of the Bank are—

(1) "To assist in the reconstruction and development of territories of members by facilitating the investment of capital for

productive purposes, including the restoration of economies destroyed or disrupted by war."

(2) "To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors."

(3) "To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment."

The authorised capital stock of the Bank is 10,000 million dollars divided into 100,000 shares with a par value of 100,000 dollars each.

Forty-four Governments are members of the Bank. So far loans amounting to $497,000,000 have been made to France, Denmark, the Netherlands and Luxembourg.

TEST PAPER

1. What is a Central Bank and how does it differ from a commercial bank?
2. What were the main provisions of the Bank Charter Act of 1844 ?
3. Give, broadly, the facts respecting the note circulation in the United Kingdom since the enactment of the Charter Act (1844). What light do they afford as to the course of monetary and banking development during this period ?
4. Make a copy of the Bank Return on page 346 and explain each item contained therein.
5. Explain, in detail, the items on the Assets side of the account of the Issue Department of the Bank of England.
6. What is the Bank Rate ? How is it connected with the Deposit Rate ?
7. Enumerate the chief causes of the changes in the Bank Rate of Discount.
8. Mention some of the consequences of a change in the Bank Rate.
9. State clearly the functions of the Bank of England.
10. The Macmillan Report states that the central bank of a country should possess four rights, viz. (*a*) to issue notes; (*b*) to hold reserves of the commercial banks; (*c*) to buy and sell securities; and (*d*) to discount bills. Explain, and enlarge on, each of these rights.
11. Does experience in Great Britain and other countries suggest that the existence of centralised banks is essential to modern banking?
12. What is the purpose of the International Monetary Fund?
13. What is the purpose of the International Bank for Reconstruction and Development?

CHAPTER XXXVII

Commercial Banking

NATURE OF COMMERCIAL BANKING.—Commercial banking may be distinguished from central banking on the grounds of the objective towards which it is directed. A commercial bank is conducted like any other business with a view to earning a maximum profit for its proprietors. It does this by rendering a variety of services acceptable to its customers with a view to increasing its connection to the greatest extent possible. A central bank, on the other hand, must take a wider view and must operate as a public institution for the benefit of the community as a whole.

Nearly all the business of the commercial banks in Great Britain is conducted by a small number of joint stock banks which have grown to their present size through a long series of amalgamations. In the nineteenth century there was a comparatively large number of banks, mostly with branches operating all over the country and in close touch with the local needs of industry and commerce. In 1913 there were forty-three joint stock banks in England and Wales, and to-day there are sixteen, of which the Big Five carry on the vast majority of the business.

EVOLUTION OF COMMERCIAL BANKING.—Records of money changing and advances on security are to be found in Babylonian and Assyrian inscriptions, and the ancient Greeks and Romans were acquainted with the systems of deposits bearing interest, and with letters of credit. Towards the end of the period of commercial and economic insecurity of the Middle Ages, various functions of modern banking were developed, especially on the Continent, where a system of offsetting mercantile debts arose out of the business of dealing in foreign money—a business indispensable to the traders who frequented the great mediaeval fairs. Before the year 1400, the Venetian money-changers had developed into recognised keepers of deposits, and certain prominent merchant families took the foremost place in business of this kind, arising out of the trade of Venice with the Orient.

So far as England is concerned, from the time of William the Conqueror to the end of the thirteenth century, the chief dealers

in money were the Jews, who made themselves so valuable to the Crown and to the nobility that they were usually allotted special quarters—the "Jewry"—and special protection in every walled town of importance. As a concession to popular prejudice, however, they were expelled from England by Edward I in 1290, their place being taken by the Lombards; these were money dealers with Central European and Italian connections, who received their nickname largely through being associated in the popular mind with their wealthier and more renowned brethren of Northern Italy. They are supposed to have settled in the district of Lombard Street, in the City of London. The jealousy of the City merchants led to the banishment of the Lombards by Queen Elizabeth.

In English banking there are good grounds for concluding that the scrivener was the first English pioneer. It was the custom in England during the sixteenth and early seventeenth centuries for merchants to entrust their book-keeping work to professional scriveners, who also acted as cashiers. This work gave them an intimate knowledge of financial and commercial transactions, with the result that during the seventeenth century they developed into particularly active moneylenders and recognised custodians of deposits. During the disturbed period of the Commonwealth and the Civil War, these scriveners so often proved themselves false to their trust, that the merchants began to transfer their cash reserves to the custody of the *goldsmiths*, who were a powerful factor in the economic development of England in later Stuart times. The goldsmiths began the practice of issuing receipts against the cash deposited with them, and these soon circulated better than actual coins, and may be regarded as the earliest form of bank notes issued in this country. These notes were issued against a kind of deposit account; but, in addition, the goldsmiths opened another type of account termed a "running cash," which was the forerunner of the modern current account. The position of the goldsmiths was, however, severely shaken in 1672 by the repudiation by Charles II's ministers of a large part of the debts of the Government. This event was of the utmost importance, as ultimately convincing the growing commercial classes that a stable banking system was a national necessity, and its influence on national thought played no small part in the foundation of the Bank of England in 1694, from which date our modern system of banking may be said to commence.

JOINT STOCK BANKING.—The early history of joint stock banking in this country is very largely a story of a struggle against prejudice and vested interests. An Act passed in 1708 amending the Charter of the Bank of England prohibited the formation of banking partnerships of more than six persons. Although the Bank repudiated the suggestion that it was attempting to interfere with the goldsmith bankers, yet in virtue of this enactment, which was renewed in 1742, the Bank of England continued to function until 1826 as the only English joint stock banking company.

To meet the requirements of the Industrial Revolution, country banks in the meantime had sprung up everywhere, whilst the establishment of the London Clearing House greatly facilitated banking transactions. These small country banks, with power to issue notes and with no great financial backing, were responsible for a series of financial crises. After a particularly serious crisis in 1825, Lord Liverpool declared that the evil lay in the hundreds of small independent issues of notes of low denomination, and that these must be swept away. At the same time it had to be recognised that the Bank of England's monopoly was out of date and that some steps should be taken to improve the stability of the country banks. In order to accomplish this latter purpose, an Act was passed in 1826 permitting joint stock companies to carry on the business of banking and to issue notes at any place more than sixty-five miles from London, provided that they did not open an office within that radius. In consequence, between 1826 and the end of 1830, fourteen joint stock banks had appeared in the provinces. They were subjected to opposition from the Bank of England and from the established private bankers, whilst all kinds of misrepresentations were made to deter people from becoming either customers or shareholders. Again, in speaking of a joint stock concern at the present day, we almost invariably associate the term with limited liability. These early joint stock banking companies were, however, large partnerships with unlimited liability, and it was not until 1879 that limited liability was conferred on the banks generally.

The Bank Act of 1833 moved a step further and permitted the establishment of joint stock banking companies of more than six persons in London, provided that such corporations did not issue notes. This measure was followed by the establishment of the

LANDMARKS IN THE EVOLUTION OF BRITISH BANKING

1694—FOUNDATION OF THE BANK OF ENGLAND

A Corporation formed to lend £1,200,000 at 8 per cent interest to the Government with £4,000 per annum grant for the expenses of management. This was to enable the Government of William and Mary to carry on the war with Louis XIV of France. The issue of notes was permissible up to the amount of the capital—£1,200,000.

1697—MONOPOLY GRANTED TO THE BANK OF ENGLAND

No other Corporation in the nature of a bank was to be established.

1708—BANK CHARTER RENEWED

Banks exceeding six persons were prohibited from issuing notes.

1720—SOUTH SEA BUBBLE

1797—SUSPENSION OF CASH PAYMENTS BY THE BANK OF ENGLAND

1810—BULLION COMMITTEE REPORT

Depreciation of notes was measured by the difference between the Mint and market prices of gold.

1819—CASH PAYMENTS RESUMED BY THE BANK OF ENGLAND

1826—BANK ACT

The right given to companies of more than six persons to issue notes when outside a radius of 65 miles from London. This created an important exception to the monopoly hitherto enjoyed by the Bank of England.

1833—BANK CHARTER ACT

This expressly declared that companies and partnerships, although more than six persons in number, might perform banking operations within a radius of 65 miles and even in London itself, provided they did not issue bank notes.

1844—BANK CHARTER ACT

This embodies the leading provisions which now govern the bank note circulation of England and Wales. The Act undertook to make the position of Bank of England Notes secure by providing for the division of the Bank into two departments—the Issue and the Banking. It also provided that the issue of notes of private banks should be strictly limited.

1847—BANK CHARTER ACT SUSPENDED

Financial crises also occurred in 1857, 1866, and 1914. In these years the Bank Act was again suspended; that is, the clause limiting the fiduciary issue was disregarded.

1857—LIMITED LIABILITY EXTENDED TO BANKS

1854—JOINT-STOCK BANKS ADMITTED TO THE LONDON CLEARING HOUSE

1914—CURRENCY AND BANK NOTES ACT

The issue of £1 and 10s. notes by the Treasury to meet the great extension of currency required to finance the Great War.

1920—ADOPTION OF THE "CUNLIFFE LIMIT"

1921—PRIVILEGE OF ISSUING NOTES FINALLY AND EXCLUSIVELY RESTRICTED TO BANK OF ENGLAND

This came about by the last of the country banks possessing the right of note issue becoming absorbed by Lloyds Bank, Ltd.

1925—GOLD STANDARD ACT

Export of gold re-permitted and a modified gold standard restored.

1928—CURRENCY AND BANK NOTES ACT

Amalgamation of Treasury notes with those of the Bank of England. The fiduciary issue of the Bank was increased from £19¾ million to £260 million.

1931—GOLD STANDARD AMENDMENT ACT

Convertibility of bank notes suspended, with the result that Great Britain abandoned the Gold Standard.

1933—WORLD ECONOMIC CONFERENCE

Resolution of Empire countries in favour of the restoration of a gold standard in some modified form.

1934—DEVALUATION OF THE DOLLAR

1936—THE TRIPARTITE MONETARY AGREEMENT

1939—CURRENCY AND BANK NOTES ACT

The fiduciary issue of the Bank was increased to £300 million.

1946—NATIONALISATION OF THE BANK OF ENGLAND

London and Westminster Bank in 1834 under the management of J. W. Gilbart, the London Joint Stock in 1836, the London and County in the same year, and the Union of London in 1839. A further very important step was taken in 1844, when the *Bank Charter Act* of that year provided that the note issues of the private and provincial joint stock banks were not to be increased in the future, and that the right to issue notes was to be relinquished by any such bank in the event of its bankruptcy or amalgamation.

The trend of events in English banking during the nineteenth century has been in the direction of *increasing concentration*, and most of the modern English joint stock banks have grown as the result of a long series of amalgamations. In 1825 there were more than 550 banking concerns in England and Wales, but by 1900 this number had declined to seventy-seven; whilst at the present day there are sixteen joint stock banks, of which the Big Five transact the bulk of the business. Any further amalgamations amongst the leading banks are extremely unlikely at the present time, since a fusion of any two of them would produce an institution much larger than other banks. Against such a danger there exists the protection of the Advisory Committee in Bank Amalgamations, which must report to the Treasury and the Board of Trade on any new banking fusion which is proposed. It is certain that no important banking amalgamation could be carried out in face of an adverse report by this Committee.

The past decade has seen sweeping changes in bank organisation and methods, and to-day the banks are amongst the most progressive of our great business institutions, both in the efficiency of their internal organisation and in their anxiety to provide ever-increasing services for their customers. In banking, as in most branches of economic activity, the *spread of mechanisation* has been exceptionally rapid. The mechanisation of bank accounting had already become an established fact in other countries before it was first introduced in England. In America, for example, the banks were faced with the relatively high cost of clerical labour and the enormous volume of cheques passing through their hands, and therefore applied mechanical accounting devices for the purpose of dealing with this work. Machines, such as the adding machine, have, of course, been employed since the beginning of the century. This machine, however, has been the basis of much more pretentious

mechanical methods, for from it has been evolved the ***modern book-keeping machine***, which not merely lists and adds, but strikes a balance between debits and credits posted to individual accounts, and produces separate cumulative totals of all debits, credits, and balances posted in a given "run." As a result, there has been an enormous speeding up of the work, while liability to error has been greatly reduced.

ORGANISATION OF A JOINT STOCK BANK.—Joint stock banks are for the most part owned by quite small investors, thus differing from the private banks or merchant banks which are owned and managed almost entirely by private individuals. The shareholders delegate their powers of conducting the business of the bank to a Board of Directors, who are necessarily shareholders. The only direct control of the shareholders is at the annual meeting, where criticism is made and voting for re-election or rejection of directors takes place. The actual daily administration of joint stock banks is concentrated in the hands of the managing director or General Manager at Head Office. Internal control is secured over the accounts through the *auditors* and their report.

Administrative Departments. The services rendered by a joint stock bank are of a multifarious nature. In addition to the control of a network of branches, it falls to the lot of the Head Office staff to conduct an ordinary banking business similar to that which is carried on at the branches. As in other undertakings, the activities of the staff may be divided into administrative and executive. The General Manager and his assistants have charge of the administrative work, which is concerned with the preparation and planning of the business transactions in readiness for their execution. The determination of the nature and extent of the operations, the supervision of the liquidity and safety of the assets, and the efficiency of the various branches of work undertaken by the bank fall upon the shoulders of the General Manager, assisted by his staff.

In small branch banks these administrative duties devolve directly upon the Manager himself; but in the large branches, and especially at Head Office, special departments have to be formed.

Control and Inspection departments keep a close watch on the conduct of Branch affairs and see that overall policy is carried out.

The Intelligence department collects and interprets information

on matters affecting the economic situation which may modify bank policy.

The Secretariat conducts the propaganda and opens up new business connections. It receives and imparts information, and lays down the general lines on which the business should be conducted.

The *Staff Department* engages and dismisses members of the staff, fixes and pays salaries, provides training facilities and keeps a careful watch over the progress of each member of the clerical staff.

The *Accountant's Department* is also under the control of the General Manager. It is responsible for the efficient organisation of the undertaking, sees to the audit of the accounts, and keeps a watchful eye over the solvency of the undertaking.

The *Legal Department* attends to all the legal questions appertaining to the business, conducts lawsuits, and supervises all matters connected with the bank's litigation.

The *Credit and Loan Department*, which has control of the bank's lending operations, attends to prospective borrowers and investigates into their financial status. It regulates the granting of credit, stipulates the requisite terms and conditions, and keeps a record of the loans actually contracted.

The *Executor and Trustee Department*, as its name implies, undertakes to act as trustee and executor on behalf of customers, and also as trustee for debenture holders.

Executive Departments. The *Cashiers' Department* embraces all the work which has reference to the receipt and payment of cash. In a large bank it is possible to arrange that certain cashiers pay and others receive, and a special division of the counter is made accordingly. Precautions must be taken in this department to safeguard the bank against forgeries. For this reason a strict control is kept over all cash transactions.

Securities Department. The principal work of this department consists in taking care of Stock Exchange securities which are the property of the bank, or of securities lodged by customers as cover for loans. In its capacity of gratuitous bailee, the bank receives customers jewellery and other valuables for safe custody. These are placed in the strong room of the bank, which is in the care of this department.

The *Coupons and Dividends Department* devotes itself to the collection and sale of the coupons detached from securities held on behalf of customers and also to the payment of dividends.

Stocks and Shares Department. This is engaged in the sale and purchase of stocks and shares on behalf of customers. These transactions are effected through the medium of official brokers, who charge the bank a smaller brokerage than usual, in view of the large amount of business done.

The *Bills of Exchange Department* deals with the recording and controlling of all bills of exchange discounted by the bank for its customers. The discounting of bills by branches, their custody in the Head Office Bill Department, and their collection at maturity form an important feature of the bank's work.

The *Foreign Department* is concerned with the business of foreign exchange, foreign credits, the remittance of funds abroad, and the issuing of drafts, letters of credit, and circular notes. The transfers involved by these transactions give rise to the necessity of maintaining corresponding currency accounts with banks abroad.

These departments deal directly with the customers. Orders which come through the post are dealt with through the *Correspondence Department,* where all the written work connected with the execution of orders is carried out. Entries are made from the paying-in slips and other vouchers into the books of first entry, and then posted into the Ledger, and ultimately the figures appear in the Balance Sheet.

The large measure of mechanisation introduced into banking can apply only to routine work; it cannot deal with banking problems which call for clear thinking, judgment, wide general knowledge of business. There probably never was a time when these higher reaches of banking offered so much scope for initiative, so many opportunities for specialisation. British banks have an extensive organisation for dealing with all types of commercial inquiries and for facilitating foreign trade. The Legal, Intelligence, Foreign, Securities, and Bill Departments of banks offer interesting and responsible work to persons with ability and initiative, and it is this type of person who will regard mechanisation as an advantage, not a hindrance.

FUNCTIONS OF A JOINT STOCK BANK.—In this country, at any rate, the main function of a joint stock bank is the receipt of money from its customers, subject to their right to withdraw such money on demand by cheque. This is the usual arrangement under which current accounts are opened and conducted; but in addition to

accepting large sums of money on these terms, the banker usually receives money on deposit account, undertaking to pay the customer an agreed rate of interest upon the balance outstanding in return for the right to demand from him an agreed period of notice for all withdrawals. Thus the bulk of the funds so deposited are accepted subject to seven days' notice of withdrawal and, although in practice banks rarely insist on the fulfilment of this condition, it is an important safeguard in the event of exceptional withdrawals.

Arising out of this function of accepting money from the public is that whereby the banker lends resources to approved borrowers. So far as Great Britain is concerned, advances by joint stock banks fall into two great categories—loans and overdrafts. A loan is made when a fixed sum is advanced for a definite period of time, say, three or six months. The borrower pays interest on the amount for the period in question. An overdraft is the right to borrow up to a given amount in excess of the customer's balance and, therefore, the amount overdrawn depends on the extent to which the facilities granted are actually made use of during the period for which they are available. Hence the overdraft is a much more elastic form of borrowing.

These two functions—the receipt of deposits and the advancing of loans and overdrafts—jointly constitute an economic service of the greatest importance. In performing this work the commercial banks effect two economies. By collecting and pooling small items of capital individually unimportant, they make a large stock of capital permanently available for business and other uses. As expert lenders they supply this capital to borrowers at relatively low rates. They divert resources from channels in which they cannot find effective employment to places where they can be utilised to further the productive process.

Apart, however, from this primary function of linking up lenders and borrowers of liquid capital, the modern joint stock bank performs a host of other functions, all of which are of considerable utility to its customers and to the community generally. These functions may be summarised as follows—

(1) To gather up unused purchasing power into a common fund, and to credit customers with their respective amounts in the form of current and deposit accounts.

(2) To use this fund by granting loans.

(3) To discount bills of exchange and promissory notes.
(4) To transmit money from one place to another.
(5) To exchange one kind of currency for another.
(6) To act as agents on behalf of customers by—
 (*a*) Making payments by cheques;
 (*b*) Collecting money due on dividend coupons and warrants;
 (*c*) Keeping valuables in safe custody.

The functions of a joint stock bank can be better understood by the examination of the items which appear in its Balance Sheet.

ANALYSIS OF BANK BALANCE SHEET.—The nature of the work performed by a banker is in its more important aspects revealed by an analysis of the balance sheet. In common with that of every other business the *liabilities side* indicates the sources from which the banker derives his funds, whilst the *assets side* shows how they are employed in the business. Broadly speaking, the banker derives his capital from two sources, viz. the inside capital, which is contributed by the proprietors, and the outside capital, provided by the depositors. Taking the items in the Balance Sheet on page 364, they may be analysed as follows—

Liabilities Side of the Balance Sheet.

THE CAPITAL. This is the capital of the bank subscribed originally by the shareholders. In this case, there is four million pounds sterling paid up, which consists of shares of £50 each, of which £8 per share has been paid. This means that every shareholder, besides holding a share on which £8 has been paid, is liable to pay up another £42. This is usually done in the case of banking shares, in order to increase the confidence of the public in the bank. If the bank, unfortunately, gets into low water and cannot meet the claims of depositors, then the shareholders, at any rate, will have this huge sum to pay up, and, consequently, there will be a large sum to fall back upon.

CURRENT AND DEPOSIT ACCOUNTS. This represents money which the bank's customers have paid into the bank in the ordinary way of business. A Current Account can be drawn upon at any moment, so long as it is not overdrawn; whereas a Deposit Account is opened on condition that the amount paid in is not withdrawn without a certain amount of notice. On this understanding, the banker usually allows the customer a rate of interest.

BILLS ACCEPTED. These are bills accepted by the bank which

the bank has made itself responsible to pay on behalf of the customers of the bank who have been buying goods, and who have asked the bank to give its name to the bills. The customer undertakes to pay the banker a certain charge or commission and to put the bank in funds before the bill is presented for payment.

From this Balance Sheet it will be seen that there are people who have so believed in the bank as to *deposit* ninety-one millions of money therein, partly because it can be cared for and partly because they can get interest for it. It has *accepted bills* for seven million pounds because customers know that everybody will believe that bills accepted by this bank will be met on the due date, and these bills will be first-rate credit instruments. People have invested capital in the bank because they believed that the enterprise would be a profitable one. The *reserve* of three millions is the sum which has been set aside by the directors of the bank, during its existence, as a further protection to the shareholders and to the depositors. Their total *paid-up capital* is four millions, and they have already accumulated out of profits not less than three millions, that is, three-quarters of their paid-up capital. The banking business is profitable, as a rule, because it is conducted with a comparatively small capital, together with the help of other people's money. In the case under consideration, the capital is four millions, but the amount deposited is ninety-one millions.

The capital is the sum paid in by the shareholders when originally subscribed, and the company has to account for the four millions. The Reserve Fund has been accumulated out of the profits, and, therefore, the bank has to account to the shareholders for the Reserve Fund, and it accounts for both these items by the assets which it holds (as stated on the opposite side of the Balance Sheet).

Assets Side of the Balance Sheet. The first item on the Assets side is the CASH IN HAND AND AT THE BANK OF ENGLAND, and this is the most liquid of the bank's assets. This item represents the actual money kept as a cash reserve against the demands made by the public. During the last few years, it has been the practice to maintain a daily cash reserve of 8 per cent of Current and Deposit Accounts. Before the war the minimum ratio was supposed to be 10 per cent, but very often it fell below this figure.

The item consists of Bank of England notes, and credit in

BALANCE SHEET

OF THE

NATIONAL JOINT STOCK BANKING CO., LTD.

AS AT 31ST DECEMBER, 19. .

Liabilities	MILLION £'s.	*Assets*	MILLION £'s.	MILLION £'s.
Capital Paid up, viz.— £8 per Share on 500,000 Shares of £50 each	4	**Cash** in Hand and Cash at Bank of England		8
Reserve Fund	3			
Balance of Profit and Loss A/c	1½	**Cash at Call** and at Short Notice, and Stock Exchange Loans		8
Current and Deposit A/cs	91			
		Bills Discounted		20
Acceptances on account of Customers	7	**Investments**—		
		War Loans and other British Government Securities	10	
		British Corporation and County Stocks	4	
		Dominion and Colonial Government Stocks and Bonds	3	
		Sundry Investments	2	19
		Advances on Current Accounts, Loans on Security and other Accounts		42
		Liabilities of Customers for Acceptances, as *per contra*		7
		Bank Premises, at Head Office and Branches		2¼
	£106¼			£106¼

the books of the Bank of England. The fact that every bank keeps a balance at the Bank of England is important, for it leads people to feel that the banking system is a single homogeneous one, with its centre as the Bank of England.

CASH AT CALL AND SHORT NOTICE means money lent, which can be quickly realised. When it is at call, the bank can call for repayment of the money advanced at any time. CASH AT SHORT NOTICE usually requires about a week's notice. This item comes next to Cash in hand, because it is peculiarly liquid. It is lent to a class of people known as bill-brokers, who are specialised dealers in bills of exchange. Some of the money is also lent to stockbrokers, who are of high standing, and always ready and able to pay back the money when called upon.

BILLS DISCOUNTED. This item consists of short-term bills of exchange and Treasury Bills.

INVESTMENTS. These are the various investments in which the bank has placed a portion of the money received from depositors, etc., and are usually of such a nature that they are easily convertible into cash in case of emergency. It will be seen that the investments stated in this Joint Stock Balance Sheet are shown in much greater detail than those in the Bank of England Return.

ADVANCES ON CURRENT ACCOUNTS represents the sum lent by the bank to its customers.

LIABILITIES OF CUSTOMERS FOR ACCEPTANCES. The bank makes commission by lending its name or accepting bills on behalf of customers. In this case, it becomes liable for the amount of the acceptances. The customers, however, undertake to meet the bills at maturity, so that they are shown on the Assets side as a *contra* account.

THE BANK PREMISES. Unlike the Bank of England Return, upon which the premises of the Bank are treated as a Secret Reserve, those of a Joint Stock Bank usually appear as an asset in the Balance Sheet.

In addition to the "Big Five," there are eleven other English banks, which include Martins Bank Ltd., Messrs. Glyn, Mills & Co., and Messrs. Williams Deacon & Co. Besides these joint stock banks, there are still in existence a few private banks, and the Chartered Colonial banks, whose significance lies in the facilities they afford in the financing of Colonial trade.

SCOTTISH AND IRISH BANKS.—During the last decade the tendency towards concentration and amalgamation which characterised English banking institutions has spread to Scotland and Ireland. Several of the Scottish joint stock banks have become affiliated to the "Big Five," although they maintain their separate identity and their power to issue notes. The first of their number to take this course was the National Bank of Scotland, Ltd., which affiliated with Lloyds Bank in 1918. Later affiliations were the British Linen Bank with Barclays, the Clydesdale Bank and the North of Scotland Bank with the Midland.

In Ireland the business of banking has been conducted with extraordinary steadiness and success. Since the passing of the Bank Act, 1845, its subsequent history pursued very closely the same process of development as in England. The credit which the banks obtained by the ready acceptance of their notes brought customers to their counters, and thus the existing system, fortunate in excellent managers, was built up gradually and surely. Irish banks experienced their full share of the political troubles from 1914–1923. Apart from the institution of the frontier between Northern Ireland and the Irish Free State, which created several new problems, many branch banks suffered damage in the disturbance. Nevertheless, progress has been made, and the banks have taken their share of the work of financial reconstruction following the inauguration of the Irish Free State in 1922. The "Big Five" have also extended their activities into Ireland; for example, the Westminster Bank acquired the control of the Ulster Bank during the 1914–18 War.

There now remains three joint stock banks, the chief of which is the Bank of Ireland, which occupies the same relation to the Government as the Bank of England has done in England. At the same time, through its many branches, it competes with the other two joint stock banks for all kinds of banking business.

PRIVATE BANKS.—Many years before the establishment of the Bank of England, an elementary form of banking was carried on by the goldsmiths in London. As they dealt in valuable metals, they were obliged to adopt special means of protecting their property. Their customers often entrusted the keeping of plate to the goldsmiths, and in course of time merchants deposited with them their spare cash for safe custody. As the money was lying idle in their safes, the goldsmiths resorted to the

practice of lending a portion at interest. With the increase in this desire or opportunity of lending, the goldsmiths attracted more deposits from the public by allowing a small rate of interest upon the amounts lodged. Against these deposits, the goldsmiths issued notes as an acknowledgment of their indebtedness; and these represent the earliest form of bank notes. Sometimes, other merchants who had acquired a reputation for skill and integrity, added banking transactions to their other business.

Such business was carried on by private firms, and, in 1708, an Act was passed prohibiting a firm of more than six partners from issuing notes. This Act prevented the development of joint stock banking, because it was thought that the issue of notes was an absolutely necessary function to enable a bank to make profit.

In 1857 the permissible number of partners in a private bank was increased from six to ten, at which number it still remains.

DIFFERENCE BETWEEN PRIVATE BANK AND JOINT STOCK BANK.— A private bank differs from a limited joint stock company in the following points—

(1) Each member is liable to the full extent of his property for all the debts of the firm. In a joint stock bank, the shareholder is liable only for the amount which has not been paid up on the shares taken. But in the case of banks of issue the members were not entitled to limited liability in respect of note issues.

(2) Each member of a private bank can make the firm liable for any debt he may contract on its behalf. For example, if he orders goods for the firm, or accepts a bill of exchange, the firm is rendered responsible.

(3) The partners generally take an active part in the management of the business; and though some refrain from doing so, and become dormant or sleeping partners, they are still liable for the debts contracted by the active partners. In joint stock companies, the management is entrusted to a supreme body, such as a Board of Directors, who appoint the higher officials; and the latter, in turn, may have authority to appoint the subordinate members of the staff. The directors have very wide powers, but they cannot engage in a business totally different from the one mentioned in their memorandum of association.

The growth of private banks up to 1810 was very considerable, and in that year there were 900 such banks issuing notes. The

great depression caused by the Napoleonic Wars caused an immense number of failures, and twelve million pounds' worth of notes went out of circulation.

Between 1793 and 1825, no fewer than a thousand private banks failed.

At the passing of the Bank Charter Act of 1844, 207 private banks were issuing notes to the extent of about five million sterling, and 72 joint stock banks with an authorised issue of three and a half millions, making a total of eight and a half millions. In 1914 there were only six private banks issuing notes, and three joint stock banks, the total authorised issue being £334,820.

The tendency for amalgamation among large joint stock banks and the rapid absorption of private country banks have led to the disappearance of these banks of issue. In February, 1921, the last of these note issuing banks, viz. Fox, Fowler & Co., was absorbed, so that the Bank of England has now a monopoly of note issue. Although the private note-issuing banks have disappeared, there still survive a few private deposit banks, one of which is that of Messrs. Hoare & Co., which can trace its history back to the seventeenth century, before the establishment of the Bank of England.

MERCHANT BANKS.—Closely allied to the joint stock banks, though not bankers in the strict sense of the term, are the merchant bankers, commonly known by the name of Accepting Houses. Their founders were almost without exception of Continental origin, but the London offices have become quite English in character during the period in which they have been established in this country. As has already been shown, the great private bankers of London built up the deposit system of banking at home, and during this period similar banking families from the Continent were gradually drawn to establish offices in London by the attraction of the great overseas trade founded by English enterprise, especially during the Napoleonic Wars. These wars ruined the Merchant Bank of Amsterdam, which had previously been the chief centre of international trade; and thus the great Merchant Banking Houses of the Continent found it worth while to set up their international offices in London. Among these may be mentioned the houses of Rothschild and Baring, Messrs. Schroeder, and Hambros Bank, Ltd.

Merchant bankers having definite connections with special foreign countries continue to carry on a very considerable business; since the 1914–18 War, however, the larger joint stock banks have tended to share in any growth of foreign business, and in several instances have established foreign branches or agencies in the chief European cities.

These merchant bankers deal almost entirely with the acceptance and discounting of bills of exchange, and some of them even import and export merchandise on their own account. They also play an important part in the issue of foreign loans in England on behalf of the countries with which they are associated. It is obvious that in times of trade disturbance or economic difficulties the giving of credit abroad may be a risky or expensive proceeding, and thus there is a necessity for a class of experts who specialise in foreign credits. Most of the merchant banks have quite definite connections with those special parts of Europe in which the particular trade interests with which they are associated are situated. They make it their business to have representatives abroad whose chief function is to know all about the principal importers and exporters of the country concerned, and to watch every change in their financial circumstances. Their standing is such that their undertaking to pay over an amount by a fixed date enables the exporter or merchant readily to obtain the credit or money down, in exchange for his goods, necessary for him to maintain his trade turnover and to pay the manufacturer without having to wait until the goods have actually been sold in the country to which they have been exported.

TEST PAPER

1. Trace the development of Joint Stock Banking in England.

2. In what respect are Joint Stock Banks dealers in credit ?

3. Draw up a *pro forma* Balance Sheet of a joint stock bank and examine the considerations which the directors of the bank must keep in view in determining the securities in which they must invest the bank's funds.

4. Mention some of the peculiarities of a banker's business which distinguish it from that of other commercial houses.

5. Mention some of the various forms of security against which advances may be made, and consider the merits of each from the point of view of the banker.

6. " Every bank loan and every bank purchase of securities creates a deposit, and every repayment of a bank loan, and every bank sale, destroys one." Explain this process in detail and indicate the limits to the bank power to give credit to-day in England.

7. What are the chief circumstances which should influence a banker in determining the amount of his reserve ?

8. The understated items have been extracted from the accounts of a Bank. Explain, briefly, what they represent.

"Liabilities of Customers on Acceptances as *per contra*" (*Cr.* side of Balance Sheet).

"Rebate on Bills not due" (*Dr.* side of Balance Sheet).

"Money at Call and Short Notice" (*Cr.* side of Balance Sheet).

"Bills Discounted" (*Cr.* side of Balance Sheet).

9. Show clearly the difference between a private and a Joint Stock Bank.

10. Indicate the relationship of banking to other branches of commerce and, in the light of your analysis, write an account of the functions of the modern banker.

11. Put down in order, giving the exact date, five of the most important events which have occurred in the history of English banking during the last hundred years, and then describe one of the events you mention.

12. Show the relation of the modern merchant banker to British overseas trade.

13. Mention *four* different kinds of banking service or facilities which English banks are able to offer their clients. Explain briefly, in each case, how the facility is helpful to the trader.

CHAPTER XXXVIII

The Practice of Banking

BANKING OPERATIONS.—Passing more generally to the operations of a banker, it is worth noticing that the banker does not, as is commonly supposed, deal merely in money. The banker is a broker of debts, for he brings together lenders and borrowers. His advice is that of the skilled expert, so that there is no harm in calling a banker a skilled professional lender. What he lends is not money, but the unused purchasing power which comes from and is measured by the excess of production over consumption. A farmer takes his wheat to market and sells it for £1,000. In payment, he receives not a thousand pound notes, but a piece of paper called a cheque, which he pays into his bank, and that piece of paper gives him the power to go into any shop he likes and there purchase goods to the extent of the £1,000 in exchange for similar pieces of paper. Thus, through the medium of the cheque he is enabled to exchange his wheat for other goods. Suppose of the £1,000, he spends £100 on different requirements, he still has left £900 of unused purchasing power. If the farmer has no desire to make further purchases for the next six months, the banker can, in the meantime, lend the unused purchasing power to other people.

From the science of Jurisprudence, it is seen that there is no right without a corresponding duty and no duty without a correlative right. In the business of banking, the customers have certain rights, whilst the banker has certain duties to fulfil. The principal functions of a banker are—

(1) To issue notes (if a note-issuing bank).
(2) To receive deposits.
(3) To discount bills of exchange.
(4) To negotiate loans.

Issue of Notes. In the early history of English banking the issue of notes was regarded as such an integral portion of the business of a banker, that it was considered futile for a person to carry on the operations of banking unless he possessed the right to issue notes.

In 1708 associations of more than six persons were forbidden to issue notes, and for many years this was regarded as a prohibition of joint stock banking, insomuch that if a company could not issue notes, it was assumed that, in consequence, it could not lend.

This state of affairs continued until 1826, when joint stock banking was permitted. At the present time, however, the function of issuing notes is of small importance in England and Wales, for the banks that formerly exercised this right have now relinquished it, and now the time has come when the only notes issued in England and Wales are those of the Bank of England.

At one time the English bank note was convertible; any person holding such a note could receive gold in return for it on presentation at the Bank of England. Under the Gold Standard Act, 1925, however, this could no longer be done with a single note, but gold bullion could be purchased from the Bank in the form of gold bars containing approximately 400 ounces troy of fine gold at the rate of £3 17s. 10½d. per ounce standard gold, and could be paid for in notes. If the Bank were unable to honour its notes, the nation would have been in a state of bankruptcy.

In 1931 Great Britain abandoned the Gold Standard and with the passing of the Gold Standard (Amendment) Act the Bank of England is no longer bound to give gold in return for its notes, not even if the value of those presented for payment is equivalent to the value of 400 ounces of fine gold. Thus, the section of the Act of 1925 relating to the sale of gold by the Bank was suspended. This is what is meant by the suspension of the Gold Standard.

The Receipt of Deposits. The bank receives deposits. This is very much the same as an issue of notes. It is often forgotten that for every deposit received by a bank, there is a corresponding debt due from the bank, as in the case of the issue of notes.

The difference between deposits on current account and the issue of notes is merely one of method. The note is evidence of the right, and can be transferred from hand to hand. The current account gives the customer a similar right, but is founded on an implied contract and is transferred by the drawing of a cheque. Of course, the banker may receive money on deposit, in which case the depositor consents to waive his

right to immediate withdrawal and promises to give the banker notice thereof, in return for which the customer receives interest.

The Discounting of Bills. A trader takes a bill, which has three months to run, to a banker, who discounts it by giving an immediate right to the payment of a smaller sum, and accepts in exchange a postponed or distant right to call for the payment of a larger amount. Suppose the bill is for £100, payable in three months, the rate of interest being 4 per cent per annum (i.e. £1 for the period under consideration). The banker credits the customer's account with £99, and gives him the right to withdraw immediately that sum in exchange for the right to call upon the acceptor for the payment of £100 at the date of maturity.

Since the first World War the commercial bill has declined in importance. In the first place, the inland bill has lost importance with the growing integration of British industry and finance, so that internal financing and the bank overdraft have taken its place. Again, a definite maturity date is frequently irksome and to the trading community more elastic arrangements are invariably welcome. In the second place, the use of foreign bills has been much reduced by restrictions on world trade and by the practice of settling overseas trade debts by documentary credits backed by banks.

The Granting of Loans. The banker lends by the simple process of entering figures in books to the customers' accounts. Suppose the bank balance of a customer stands at £490, and a loan is made to him by the banker of £500. In the Pass Book there will be entered to the credit of the customer the balance of £490, together with the advance of £500 (i.e. a total of £990), against which the customer can draw. If the banker were to dishonour a cheque for £600, he would at once be subject to legal procedure on the part of the customer for damages. If a banker lends money, it at once becomes the inalienable right of the customer to draw cheques against the loan.

The fundamental difference between the business of banking and that of the trader is to be found in the phrase "on demand." In all probability there is no other group of business men who are instantly bankrupt if they cannot pay their debts at a moment's notice. Payment "on demand" is the essence of the banking business. Another curious fact is that no banker is solvent. Every banker lives in a chronic state of insolvency, that is to say,

there is no bank in the world of which it could be said that it could repay the total property of the customers at a moment's notice. If that were the case, it would mean that the banker had invested nothing and, in consequence, was earning nothing.

However incongruous it may appear, every banker undertakes to do, on pain of instant bankruptcy, what no bank in the world could possibly do if it were asked—that is, pay all its customers in full at a moment's notice.

The banker works upon the assumption that only a certain percentage of his customers will demand payment on any particular day. He must, however, keep sufficient reserve to ensure his safety. He must lend or invest as far as is necessary to make profits, but he must go no further than is safe, or he may be rendered bankrupt. It is on account of his skill and experience that the banker is able to decide how much he must keep in reserve and in what form he must keep it.

THE ASSETS OF A BANKER.—The assets of a banker may be arranged in order of liquidity as follows—

(1) **Cash in hand,** including his reserve at the Bank of England.

(2) **Money at Call and Short Notice,** that is, money lent on the money market to brokers from day to day, and money at short notice, not including loans for longer than seven days as a rule.

(3) **Stock Exchange Investments.** These consist of first-class investments, which could be easily sold in normal times. At the outbreak of war in 1914 and 1939, a Moratorium was passed. If all the bankers had been compelled to meet their payments, their investments would not have realised sufficient to save them from bankruptcy.

(4) **Bills of Exchange.** These are very good investments for the banker, since their date of maturity is fixed. In a sudden emergency, however, the bill of exchange does not constitute a shield, since it is not due until a certain future time and the banker cannot get the value until the time has elapsed, unless he rediscounts his bills, a practice not generally adopted in this country.

(5) **Loans to Customers.** These are of little use at the time when the banker is suddenly called upon to pay, for that would be the time when the customer would also be called upon.

RELATION OF THE BANKER TO HIS CUSTOMER.—The relation between a banker and his customer is that of debtor and creditor,

but the customer is in a better position than an ordinary creditor, because he can claim repayment without notice by simply drawing a cheque; and the banker is in a worse position than an ordinary debtor, because he is called upon to repay a loan without notice; and if he fails to pay promptly, especially if a cheque has been given to a third party, he will be liable to an action for damages for injury to his customer's credit. If the banker becomes insolvent, the customer can only obtain a dividend from his estate like any other creditor who has supplied the banker with goods. A customer has strictly no property lying at his bankers, unless he happens to have deposited a sum of money to be kept by the banker in safe custody. He may have a considerable sum to the credit of his account, but, unless he withdraws the amount before the trustee in bankruptcy intervenes, he will stand on the same footing as a trading creditor.

A banker who accepts a deposit makes a contract with his customer. He contracts to pay as directed; and if he pays other than as directed, he is liable to the customer. If a cheque is presented to a banker with a forged signature, and paid, the general rule is that the banker suffers the loss. From this will be seen the importance of cultivating a proper signature.

If a banker pays a post-dated cheque prior to the date mentioned thereon, he cannot debit the customer's account with the amount until the actual date of the cheque is reached.

A cheque to order can be paid only to the payee or endorsee of the cheque, but the endorsement need not be verified by the paying banker, because it is obvious that he could not know it. The banker must know the signature of his customer, but not everybody's signature. He must know that an endorsement is prima facie correct, although he is not expected to know that it is the handwriting of the right person. The Cheques Act, 1957, abolishes endorsement of order cheques paid into the account of the payee.

Again, there are other relations in which a banker stands to a customer. He may receive the bonds of a customer, detach the coupons, and place the resulting interest to the customer's account. In that case, he becomes a trustee for the customer, and may not convert such bonds to his own use. If he does, he will be criminally liable. At the same time, the banker is not entirely powerless in this matter. He may acquire a banker's lien or title

and, although he has no rights of sale, he has the right to detain them until any debt due by his customer to himself has been paid.

THE BANKER AS A LENDER.—In the banking world there are quite a considerable number of well-known rules guiding the action of bankers in the matter of making loans to customers.

Generally speaking, borrowers from bankers are of three kinds: Private persons, commercial firms, and registered companies.

Private Persons. The banking rules with regard to loans to private persons are—

(1) Do not discount such bills. A private person has no business with bills of exchange, and the probability is that they are accommodation bills.

(2) Remember that private incomes may cease at death: so that if a loan is made to a person whose income is a professional one, the terms should be made to include life insurance on the borrower.

Commercial Firms. Very frequently a commercial firm borrows, because it has urgent need of funds to maintain credit. In this case, the rules are—

(1) Ask for a balance sheet before making the loan, because in a simple viva voce interview the would-be borrower is apt to put a rosy construction on his circumstances, whereas actually to draw up and sign a balance sheet which is not true would be a criminal offence.

(2) Remember that a partner binds the firm. This is a rule rather in favour of lending, for, although an intending borrower may be of doubtful repute, as a member of a particular firm he may be a most desirable one.

A Registered Company. The most usual case is that of lending to a registered company. In this case, the bankers' rules are—

(1) Consult the Articles of Association of the company, because they will reveal the powers possessed by the directors; and a careful inspection of the Articles of Association will ensure that the borrowing is not *ultra vires*.

(2) In the case of new companies, be careful to see the registrar's Trading Certificate, because, according to the Companies Act of 1948, the contracts of a public limited company are not binding until the company is entitled to commence business, that is until it has allotted a considerable proportion of its shares.

(3) If it is a limited company, take security for the loan, or get some of the substantial directors to accept a joint and several guarantee, which will make them really liable. Title deeds to property are often accepted as security; but, in practice, it is usual to avoid the taking of second mortgages, and to take good care that the validity of title to property mentioned in the deeds is carefully scrutinised.

Letters of Credit. These are instruments addressed to agents or correspondents abroad and are handed by a banker to a customer, thus enabling the latter to obtain payment for a certain sum, or of his drafts up to a certain fixed limit. A letter of credit contains specimen signatures of the holder, and payments made thereunder must be endorsed thereon and duly advised to the issuer.

Some of these instruments promise acceptance of bills of exchange by the issuers. If the promise is absolute, the credit is termed an *open* or *clean* credit, whereas if the acceptance is made conditional on the remittance of documents of title to goods, it is termed a *documentary credit.* Documentary and clean credits are of great importance in financing exports and imports as they protect the foreign exporter by enabling him to draw bills for the amount of his exports on a bank with a world-wide reputation, thus facilitating negotiation of the bills and ensuring payment for the goods.

A letter of credit issued by a banker and promising to accept bills drawn upon him by a merchant abroad is known as a *confirmed credit.* This helps to support the importer's credit so that the foreign exporter has more reason to expect that the bills drawn by him will be met.

Advantages of a Banking Account. The advantages of a banking account to a tradesman are—

(1) His surplus cash is kept in safety.

(2) There are greater facilities for making and receiving payments than by cash, e.g. by the use of cheques.

(3) If he needs further capital to extend his business, he can obtain it more easily and cheaply from a banker than from anyone else.

(4) He can increase his operations by selling his book debts to the banker in the form of bills of exchange.

(5) By using bankers' credits he can obtain goods from foreign suppliers which would otherwise be impossible. He can sell also in perfect safety by the same means.

OPENING AN ACCOUNT.—Letter of Introduction. Accounts should never be opened for a stranger without an introduction from someone known to the bank, or without making inquiry either from another bank or from some other satisfactory source. Even this procedure is not an absolute protection against fraud, but it minimises the risk.

Paying-in Slip. An account is opened by paying in cash, cheques or bills to the credit of a customer. The amount of each sort is written on a printed slip, which consists either of a single leaf or is taken out of a book bound with counterfoils.

The amounts paid in for credit to an account become the property of the bank to whom the customer has entrusted the money, subject to the condition that the bank must repay on demand, which is usually made when a cheque is drawn. Such an account is known as a *Current Account*, since the customer can add to it or withdraw the whole or part of it without giving notice. As a rule, the banker gives no interest on such an account.

When money is lodged at interest with a banker and cannot be withdrawn without notice being given, such an account is known as a *Deposit Account*, and must be kept separate from the Current Account.

SIGNATURE BOOK.—On opening a banking account, the prospective customer is required to provide specimens of his signature so that the bank can verify signatures on cheques drawn on his account. The signature often differs from a full name by the abbreviation of the Christian names or by writing only the initials of those names. It would be safer for the customer to adopt one particular form for his permanent signature. A short name is best written in full, because the longer a name, the greater is the facility in detecting a forgery. However, a customer should be left to follow his usual practice, for any departure from his ordinary method of signing might lead in the end to a suspicion of forgery, although the signature is perfectly genuine. The most difficult signature to forge is that which is most legibly written.

CHEQUE BOOK.—A book of cheque forms is supplied to the customer, and he is charged with the price of the stamps at the rate of twopence for each cheque. Customers not in business usually prefer a book of fifty or even twenty-four cheques. Large firms and companies may find it convenient to have books of

500 cheques, with four cheques on each page divided by perforations. Such cheques may also have the name of the firm or company printed on them as protection against forgery.

John Brown, Esq.

SHEET No 27

Statement of account with LLOYDS BANK, LTD., CARDIFF

Date	Particulars	Payments	Receipts	Dr. or Cr.	Balance
19—					
Jan. 1	Brought Forward		300	Cr.	300
„ 2	Cash . .		30	Cr.	330
„ 4	Self . .	5		Cr.	325
„ 5	Jones & Co. .	11 10		Cr.	313

PASS BOOK STATEMENTS.—These are furnished in loose leaf form, on the lines of the specimen shown above, when required by the customer.

The Pass Book Statement is written up by the bank and is a statement of the customer's account. It should be obtained from the bank frequently, in order that the customer's cash book may be verified with the bank account.

It is important to notice that the counterfoils of the cheque book above mentioned are convenient records of the cheques drawn by the customer, and are useful in checking the Pass Book Statements. The counterfoils of the paying-in slips, when they are bound in book form, serve a similar purpose with regard to the credit side of the Pass Book Statements.

Any error discovered by the customer must be communicated to the bank within a reasonable time, otherwise it will be assumed that the account is correct. What is a reasonable time is a question of fact and depends upon the circumstances and upon the method of doing business. A few banks send acknowledgment forms, once or twice, a year, to be signed by the customer ; but, in order to save expense, the forms are sent only to customers whose debit or credit balances exceed a certain amount. This is intended as a safeguard against

omissions or insertions of wrong amounts in the customer's account. It also acts as a check upon the members of the bank's staff, and was probably chiefly framed for that purpose. If the customer is credited with too much in his Pass Book Statement, and is led to believe from the account that a certain balance is due to him, the banker will be bound to honour cheques to the extent of such balance, and will be liable for damages in case of refusal. Any error may be rectified by the banker on giving notice to his customer ; and if the notice is received before any cheques are drawn against a supposed balance, the banker will incur no liability if he dishonours cheques which exceed the amount actually due by him.

Reconciliation Statement. Since the Pass Book Statement shows what has been paid into the bank, and what has been paid out, the balance of the Pass Book Statement should equal the balance of the Cash Book. This seldom happens in practice, however, for the following reasons—

(1) Cheques may have been drawn in payment of accounts and entered in the Cash Book, but not in the Bank Pass Book Statement, owing to their not having been presented to the bank for payment prior to the date upon which the two books are compared.

(2) Country or foreign cheques may have been paid into the bank and entered in the Cash Book, but not credited in the Pass Book Statement, owing to their not having been cleared, i.e. owing to their value not having been received by the bank.

(3) Charges made by the bank for collecting drafts, etc., may not have been entered in the Cash Book.

In spite of the fact that the Pass Book Statement balance may not agree with the Cash Book balance, a statement can be prepared explaining this divergence, called a Reconciliation Statement. This is a statement which shows the causes of the difference between the balances of the Cash Book and the Pass Book Statement on any given date. The balance shown by the Pass Book Statement is set down, and the items in the two are compared. To this balance are added all moneys paid into the bank which have not been credited by the bank at the date of striking the balance, and from the new balance is deducted all cheques drawn on the bank which have not been cleared; or the order of procedure may be reversed. The new balance should then agree with the balance on the Cash Book.

The example of such a Statement is shown on page 381.

It is the usual practice for the cashier to write up, in red ink, a copy of the Reconciliation Statement in the Cash Book itself for the convenience of future reference.

PAID CHEQUES may be returned to the customer with the Pass Book Statement when it is drawn, and this is the more usual course in London. They may, however, be returned at the end of six or twelve months, when the balance of the account is struck between the bank and the customer.

Although London practice is to return cheques with the Pass Book Statement, country banks usually retain them. The payment of bills of exchange accepted payable or domiciled at the bank is regulated by agreement. It is not customary for the banker to pay such bills without the express or general authority given by the course of dealing between them. The banker is in a more secure position by receiving the customer's express authority, because he runs less risk of paying a forged acceptance. When bills are discounted, the amount of the bill is put to the credit of the customer, and he is charged with the discount.

If the bills have only a few days to run before they become due, they are called *short bills*; and they are simply held for collection until the due date, when the customer receives credit.

If the customer holds stocks or shares in a company, he may give authority to the secretary of the company to pay the dividends to a bank. He is thus spared the trouble of paying in the dividend warrant to the credit of his account. The bank sends, as an acknowledgment to the customer, the counterfoil or top

RECONCILIATION STATEMENT, 31st December, 19..

	£	s.	d.	£	s.	d.
Balance as per Bank Pass Book Statement .				205	15	5
DEDUCT Cheques drawn, but not yet presented for payment, viz.—						
Allen & Co.	101	4	8			
Brown & Co.	41	0	10			
				142	5	6
				63	9	11
Add Cheques paid in, but not cleared—						
Curtis & Son	84	14	9			
Dewar & Co.	98	0	2			
P. Jones	208	16	4			
				391	11	3
Balance as per Cash Book . . .				£455	1	2

portion of the dividend warrant, and thus intimates that the amount has been put to the credit of the customer's account.

A customer having regular payments to make, such as insurance premiums or annual club subscriptions, may give his bank a Standing Order to make these payments when due and to charge them to his account.

CHANGES IN BANKING METHODS.—The past fifty years have seen great changes in banking methods as well as banking structure. Perhaps the most conspicuous of these changes is shown in the far greater variety of the services rendered by the banks. Among other things may be mentioned the more efficient arrangements for the collection of coupons and dividends, and for the safe custody of securities, deeds, and other valuables; the issue of letters of credit and travellers' cheques; the greater ease in conducting foreign exchange operations owing to the concentration of demands to buy and sell foreign currency being in fewer hands; the pooling of the knowledge and experience of many minds; the standardising of the legal procedures involved in banking; the increase of uniformity in the matter of interest allowances and charges and in the commissions and fees for services rendered; the provision of night safes; the improvement of facilities for the exercise of thrift; and services in the capacity of executor or trustee. But the most advantageous of all is the service performed through the cheque system, which in its widespread use is a product of the past half-century.

TEST PAPER

1. What are the functions of a Banker ?
2. Examine critically the nature of bank deposits. Is it true to say that "the greater part of the banks' deposits is seen to consist, not of cash paid in, but of credits borrowed" ?
3. What is meant by discounting Bills of Exchange ?
4. What is the fundamental difference between the business of Banking and that of ordinary trade ?
5. How are the assets of a Banker arranged in order of liquidity ?
6. What is the relation of the Banker to his customer ?
7. What rules usually guide the Banker in making advances to his customers ?
8. What formalities are necessary in opening a Banking Account ?
9. What is the difference between a Deposit and a Current Account with a Bank ?
10. Explain the object of the Pass Book Statement.
11. In what way does a banking account benefit a retail trader?

12. **Describe the information a trader would expect to find in his Bank** Pass Book Statement. If the balance of the Pass Book Statement did not agree with that shown by his Cash Book, what steps are necessary to reconcile the two?

13. **Prepare a reconciliation statement as at the 31st January last, between** the Pass Book Statement and Cash Book of Thomas Stone. The following are the particulars: Balance as per Pass Book Statement, £420 6s. 2d. On the 29th January the following cheques were drawn: A. Brown, £25 10s. 4d.; C. Dison, £42 4s. 6d.; E. Farrer, £67 3s. 2d.; Wages, £30. Of these only the wages cheque had been presented. £130 10s. 2d. had been paid into the bank on the 31st January, but this had not been credited in the Pass Book Statement.

14. **It has been said that the British banking system provides for the transfer of capital from those having a surplus to those who can utilise it. Write an account of the means whereby the banker performs this service.**

15. **"Banks lend freely to credit-worthy borrowers, but they refuse to tie up their depositors' money in long-term advances." Explain and elucidate.**

16. **Set out the advantages which a well-established retailer may expect to enjoy from the possession of an account with a bank.**

17. **What do you understand by a documentary credit, and what points would you take into consideration in dealing with a request from a customer in Bristol to open a documentary credit in Bordeaux on his behalf for the import of burgundy from France?**

CHAPTER XXXIX

NEGOTIABLE INSTRUMENTS

A NEGOTIABLE INSTRUMENT is an instrument on delivery of which the legal right to the money secured or represented by it is transferable from one person to another.

A non-negotiable instrument is an instrument of such a kind that the legal right secured or represented by it cannot be transferred by mere delivery, but only in some other manner prescribed by law; e.g. in the case of an ordinary debt by an assignment in writing under the provisions of the Judicature Act, 1873.

Originally, a debt could not be assigned from one person to another, that is to say, it could be sued for only by the creditor himself, but the necessities of commerce caused this rule to be relaxed. Thus, by the custom of merchants, or the Law Merchant, as it is generally called, debts secured by bills of exchange became assignable by endorsement and delivery of the bills, whilst with regard to debts not so secured, it is now provided generally by the Judicature Act, 1873, that every debt can be assigned from one person to another so as to pass and transfer—

(1) The legal right to the debt.

(2) All legal and other remedies for the debt.

(3) The right to give a good discharge for the debt without the concurrence of the assignor; subject, however, to the following conditions, viz.—

(*a*) The assignment must be absolute; that is to say, it must not be one purporting to be by way of charge only;

(*b*) The assignment must be in writing under the hand of the assignor;

(*c*) Express notice of the assignment in writing must have been given to the debtor; and

(*d*) The assignee takes the debt subject to equities, i.e. subject to all grounds of defence which the debtor could have set up in any action which might have been brought against the assignor; e.g. that the assignor had no title, or only a defective title.

Hence, even at the present day, in the case of an ordinary debt,

that is, one which is not secured by a negotiable instrument, the assignee cannot have, and cannot give to a third person any better title to the debt assigned than the assignor had.

CHARACTERISTICS OF NEGOTIABILITY.—On the other hand, there are certain instruments known to the law, and called negotiable instruments, the property in which will pass like the current coin of the realm, provided they have been put into that form in which, according to the custom of the money market and merchants in England generally, they are freely transferable from one person to another by mere delivery. Hence, a negotiable instrument differs from one which is non-negotiable, but which is assignable only, in that—

(1) *A negotiable instrument passes freely from hand to hand by delivery either—*

(a) *without endorsement if it is payable to bearer; or*

(b) *with endorsement if it is payable to order;*

whereas a non-negotiable instrument can be transferred from one person to another only with the formalities, and subject to the conditions, prescribed by some Act of Parliament.

(2) The holder of a negotiable instrument can sue upon it in his own name without having given any kind of notice of his holding to the person liable to pay on the instrument, whereas the assignee of an ordinary debt must give notice in writing of the assignment to the debtor.

(3) The holder of a negotiable instrument is presumed to have given consideration for it. That is to say, in any action brought upon the instrument, the burden of proof lies on the defendant to show that the holder of the instrument did not give consideration for it; whereas if the holder of a non-negotiable instrument sues upon it, the burden of proof is upon him to show affirmatively that he gave consideration for it.

(4) The holder of a negotiable instrument, provided he is a holder in due course, is not prejudiced by any want or defect of title on the part of the person from whom he took the instrument, or of previous holders of the instrument; whereas the holder of a non-negotiable instrument takes it subject to equities, that is to say, he can have no better title to the instrument than the person from whom he received it had Hence, if such latter person has stolen the instrument, the holder has no title to it, and

cannot give any title to a transferee of the instrument. A holder in due course of a negotiable instrument, or, as he is sometimes called, a bona fide holder for value, means a holder who has taken a negotiable instrument which is complete and regular on the face of it, in good faith and for value, and without notice at the time when the instrument was negotiated to him of any defect in the title of the person who negotiated it.

Every holder is prima facie deemed to be a holder in due course, and the onus of proof is on the defendant in an action to show that the plaintiff did not take the instrument in good faith. By the Bills of Exchange Act, 1862, Section 90, " a thing is deemed to be done in good faith, within the meaning of this Act, where it is in fact done honestly, whether it is done negligently or not." Hence, in order to show that the holder of a negotiable instrument is not a bona fide holder for value, it must be proved affirmatively either—

(1) That he had actual notice of some defect of title on the part of the person who negotiated it to him; or

(2) That he had constructive notice of some such defect in the sense that the circumstances under which he took the instrument were such as would have aroused the suspicions of any ordinary prudent man of business, and that he wilfully abstained from making such inquiries as would have disclosed to him the defect of title.

CREDIT INSTRUMENTS

- **Negotiable**
  - **By Statute**
    - **Bills of Exchange**
    - **Bank Notes**
  - **By Custom**
    - **Exchequer Bonds**
    - **Circular Notes**
    - **Debentures to Bearer**
    - **Dividend Warrants**
- **Non-Negotiable**
  - **Postal Orders**
  - **Share Certificates**
  - **IOU's**
  - **Letters of Credit**

KINDS OF NEGOTIABLE INSTRUMENTS.—An instrument can become negotiable only in one of two ways, viz.—

(1) By the authority of an Act of Parliament: e.g. bills of

exchange, cheques, and promissory notes under and by virtue of the Bills of Exchange Act, 1882; or

(2) By the universal custom of the money market and merchants in England. If an instrument is non-negotiable according to the custom of the merchants in England, it cannot be treated as negotiable in the English Courts, even though it is negotiable according to the custom of merchants where it was issued. On the other hand, a foreign instrument is not negotiable in England unless it is also negotiable in the country where it was issued, but that it is customarily transferable from hand to hand by mere delivery in England is a prima facie indication that it is so transferable in other countries also. The following are examples of instruments which have become negotiable by custom—

(1) Circular Notes.

(2) Dividend Warrants to bearer issued in respect of fully paid-up shares.

(3) Scrip Certificates entitling the bearer to shares in a company.

(4) Bonds or Debentures payable to holder or bearer, whether they are Government bonds or trading bonds or debentures, and whether they are foreign bonds and debentures or English ones.

On the other hand, the following instruments are not negotiable instruments in the fullest sense of the word, although they may be transferable or assignable from one person to another, viz.—

(1) Share or Stock Certificates.

(2) Debenture Stock Certificates.

(3) Share Transfers.

(4) Post Office Orders.

(5) I O U's.

(6) Bonds or Debentures not payable to holder or bearer but only to the registered holder.

In some cases, instruments are now judicially recognised as negotiable instruments, and in any legal proceedings in regard to such instruments, it is not necessary to tender evidence that they are negotiable instruments, because their negotiability is a fact of which the Court itself will take judicial notice; e.g. the negotiability of bonds or debentures to holder or bearer has been so frequently established in various actions at law that the Court now

takes judicial notice of it. In all other cases the question whether an instrument which has never been solemnly recognised by the law is negotiable, whether it is customarily transferable by mere delivery or not, is a question of fact, which must be in each case left to the determination of the jury. If an instrument is found to be transferable by delivery according to the custom of the money market and merchants in England, the fact that such custom is of recent origin will not prevent it from being treated in law as a negotiable instrument, because the Law Merchant is not fixed, but is capable of being expanded to meet the requirements of commerce, so as to adopt from time to time those usages of merchants which are found necessary for the convenience of trade.

TEST PAPER

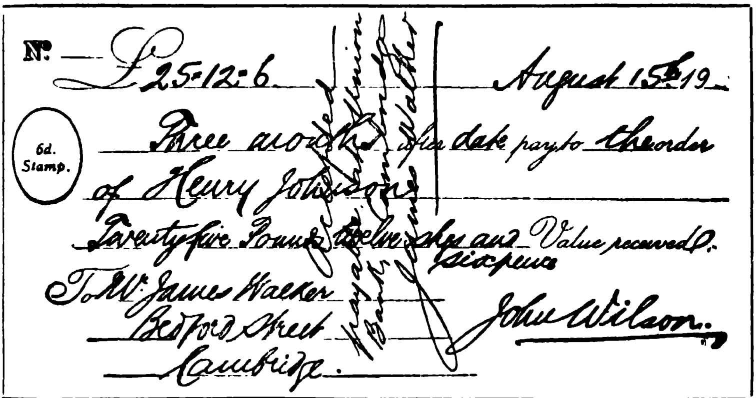
1. What is meant by negotiability? What kinds of things are apt to possess this attribute and with what results?
2. What is the meaning of the term "not negotiable"? Illustrate your answer by a practical example of the application of this phrase
3. Distinguish between a negotiable and a non-negotiable instrument.
4. Mention certain documents that are, and others that are not, negotiable in the United Kingdom.
5. Can debts be assigned? If so, under what conditions?
6. How can it be shown that the holder of a negotiable instrument is not a bona fide holder for value?
7. In what two ways can an instrument become negotiable?
8. Give four examples of instruments which have become negotiable by custom.
9. Give three examples of instruments which are not negotiable in the fullest sense of the word.
10. What is a negotiable instrument? Do all or any of the following documents come within that description—
    (a) A Bill of Lading?
    (b) An uncrossed cheque payable to order?
    (c) A postal order?
11. Explain in regard to negotiable instruments the following terms—
    Holder in due course. Transferor by delivery.
    Special endorsee. Blank acceptance.
12. When does a bill which is negotiable in its origin cease to be negotiable? What is the position of a person who takes an overdue bill in settlement of a debt?
13. Distinguish between "negotiability" and "assignment," emphasising in particular the exact nature of the former, and giving examples of instruments or documents that can be regarded as negotiable.

CHAPTER XL

Bills of Exchange

A BILL OF EXCHANGE is "an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer."

The following is an example of a Bill of Exchange—



No. — £25:12:6 — August 15th 19

6d. Stamp.

Three months after date pay to the order of Henry Johnson Twenty five Pounds twelve shillings and sixpence Value received.

To Mr James Walker Bedford Street Cambridge.

John Wilson.

An instrument which does not comply with these conditions, or which orders any act to be done in addition to the payment of money, is *not* a Bill of Exchange. But the sum payable by a bill is deemed to be a sum certain within the meaning of the definition, although it is required to be paid

(*a*) With interest;

(*b*) By stated instalments;

(*c*) By stated instalments, with a further provision that, upon default in payment of any instalment, the whole shall become due; or

(*d*) According to an indicated rate of exchange.

Where the sum payable is expressed in words and also in figures, and there is a discrepancy between the two, the sum denoted by the words is the amount payable.

Advantages of Bills of Exchange. The chief advantages of a Bill of Exchange are—

(1) It fixes beyond dispute the amount owing and the time when the debt is to be paid, and affords a quicker legal remedy than an ordinary contract claim.

(2) It may be discounted, thereby enabling a party to receive the money at once, and thus "anticipate the future," and keep his money constantly employed; whilst, on the other hand,

(3) It enables a trader to obtain the use of the goods, and affords him an opportunity of manufacturing or re-selling them, before payment becomes due; in other words, it enables him to obtain extended credit legitimately.

(4) The bill is negotiable (i.e. the debt may be assigned or transferred to another party, who may again transfer it; and so on: thus transferring value from one to another, without the actual transmission of money).

Essentials of a Bill of Exchange. The essentials of a Bill of Exchange are—

(1) The date
(2) The period of currency
(3) The parties
(4) The amount
(5) The stamp

DATE. A Bill of Exchange is not invalid by reason that it is not dated. But the date may be inserted by any holder, and such date is afterwards deemed to be the true date until the contrary is proved. Nor is it invalid because it is dated on a Sunday, or is ante-dated (i.e. dated backward), or post-dated (i.e. dated forward). In calculating the due date of an inland bill, three days ("Days of Grace") are added; and if the last of these days falls on a Sunday, or on a holiday other than a bank holiday, it is payable on the preceding day; but if it falls due on a bank holiday, it is payable on the succeeding business day. But when the last day of grace is a Sunday and the second day of grace is a bank holiday, the bill is due and payable on the succeeding business day. Any alteration of the date must be confirmed by the drawer and the acceptor.

A bill may be made payable on demand, at sight, on some fixed date, or so many days or months after sight or after date. Days

of grace do not apply to bills payable on demand, at sight, or on some fixed date.

PERIOD OF CURRENCY. Where a bill is payable at a fixed period after date, after sight, or after the happening of a specified event, the time of payment is determined by excluding the day from which the time is to begin to run and by including the day of payment. The term " month " in a bill means a calendar month.

Where a bill is payable at a fixed period after sight, the time begins to run from the date of the acceptance if the bill is accepted.

A bill payable on demand should be presented " within a reasonable time " after it is first issued, otherwise it is deemed to be overdue, and the disabilities attaching to an overdue bill attach to it. The Bills of Exchange Act does not fix any time within which a demand bill must be presented for payment, but simply states that the facts of the particular case must determine what is a reasonable time.

Where a bill is drawn in one country and is payable in another, the due date thereof is determined according to the law of the place where it is payable. For example, the French Code does not allow days of grace; and, therefore, a bill drawn in Paris on London is entitled to three days of grace, while a bill drawn in London on Paris is not entitled to any days of grace

PARTIES. The person who gives the order to pay is called the *drawer* of the bill. The person to whom the order is given is called the *drawee*, in the first instance; and when he agrees to pay in the manner required by law—the *acceptor* of the bill; and the person in whose favour the order is given is called the *payee* of the bill. Again, the person signing his name on the back of the bill is the *endorser*, whilst the person to whom it is endorsed is the *endorsee*.

AMOUNT. The sum payable must be stated in words and also in figures. If there should be a difference between the two, the amount in words governs, and payment thereof can be enforced. In practice, however, it is customary to pay whichever happens to be the smaller amount.

STAMP. A Bill of Exchange must be drawn on stamped paper and the stamp must be an *ad valorem* impressed stamp, except in the case of a bill or cheque payable on demand (or at sight),

or three days after date or after sight, where the duty is twopence, irrespective of the amount. In the latter case, the stamp may be an adhesive one, and may be affixed by the party who draws the same, or the banker to whom it is presented for payment, and cancelled by him.

Formerly, if a bill was made payable to a particular person without the addition of the words "or order," it would not have been negotiable. But by the Bills of Exchange Act, 1882 (Sect. 8), a bill is now payable to order if it is either—

(*a*) Expressed to be so payable; or

(*b*) Expressed to be payable to a particular person, provided always that it does not contain words prohibiting transfer.

On the other hand, when a bill, either originally or by endorsement, is expressed to be payable to the order of a specified person, and not to him or his order; it is nevertheless payable to him or his order at his option. When a bill contains words prohibiting transfer, it is valid as regards the parties thereto, but it is *not* negotiable.

LOST BILLS OF EXCHANGE.—Formerly, if a bill were lost, no action could be brought in respect of the amount payable thereon, because there was always the possibility that the bill might have got in the hands of a bona fide holder for value. But by the Bills of Exchange Act, 1882, where a bill has been lost before it is overdue, the holder may apply for another bill of the same tenor, on his giving security to indemnify the drawer in case the bill alleged to be lost is found again. If the drawer refuse to give such duplicate bill, he may be compelled to do so.

In any proceedings on a bill, the Court may order that loss of the instrument shall not be set up, provided an indemnity is given against the claims of any other person upon the instrument in question.

PERSONS LIABLE ON A BILL.—No person can incur liability upon a bill unless he signs it, provided—

(1) Where a person signs a bill in a trade or assumed name, he is liable thereon as if he had signed it in his own name.

(2) The signature of the name of a firm is equivalent to the signature by the person so signing of the names of all persons signing as partners in that firm.

A signature by procuration (or *per pro.*) operates as notice that

the agent so signing has but a limited authority to sign, and the principal is bound by such signature only if the agent in so signing was acting within the actual limits of his authority.

On the other hand, where a person signs a bill and adds words to his signature, clearly indicating that he signs for or on behalf of a principal, or in a representative capacity, he is not personally liable thereon.

CLASSIFICATION OF BILLS.—A bill may be either—

(1) An inland bill ; or

(2) A foreign bill ;

but unless the contrary appears on the face of the bill, the holder may treat it as an inland bill.

An inland bill is one which is, or on the face of it purports to be—

(*a*) Both drawn and payable within the British Islands ; or

(*b*) Drawn within the British Islands upon some person resident therein.

Any other bill is a foreign bill.

Differences between Inland and Foreign Bills. The principal points of difference between them are—

(1) When a foreign bill is dishonoured, protest is necessary to charge any person liable on the bill other than the acceptor. In the case of an inland bill, it is optional.

(2) Foreign bills are sometimes payable at a usance, which means the period of time customary for payment between the two countries where the bills are drawn and are made payable, respectively. The usance is not applicable in the case of inland bills.

(3) An inland bill usually consists of one document only, whereas a foreign bill is sometimes drawn in a set (i.e. in two or more parts), each part of the set being numbered and containing a reference to the other parts, and the whole of the parts constituting one bill only, so that where any one part of a bill drawn in a set is discharged, the whole bill is discharged.

ACCEPTANCE.—The acceptance of a bill is the signification by the drawee of his assent to the order of the drawer. An acceptance is invalid, unless it complies with the following conditions, viz.—

(1) It must be written on the bill and signed by the drawee, but the mere signature of the drawee without the additional words is sufficient ; and

BILL OF EXCHANGE WITH ACCEPTANCE

Stamp

No. [redacted] $ [redacted] London, E.C. August 15th 19.

Ninety Days after sight of this FIRST of Exchange (second and third of the same tenor and date unpaid) pay to the order of The Velvet [illegible] Company

[redacted]

Value received

Accepted 25th Aug/19
payable at [illegible] Bank of
New York
The American Supply Co.

To The American Supply Coy.
5. Twenty Sixth Street
New York.

For and on behalf of
THE ENGLISH CARPET COMPANY, LTD.

John Jones. Director

S. Johnson Secretary

(2) It must not express that the drawee will perform his promise by any other means than the payment of money.

A copy of an Acceptance is shown on page 394.

Kinds of Acceptance. An acceptance may be either *general* or *qualified*.

A GENERAL ACCEPTANCE assents, without qualification, to the order of the drawer.

A QUALIFIED ACCEPTANCE, in express terms, varies the effect of the bill as drawn. In particular, an acceptance is qualified which is—

(1) Conditional, i.e. makes payment by the acceptor dependent on the fulfilment of a condition therein stated—e.g. accepted payable on receipt of bills of lading.

(2) Partial, i.e. an acceptance to pay part only of the amount for which the bill is drawn.

(3) Local, i.e. an acceptance to pay only at a particular specified place. But an acceptance to pay at a particular place is a general acceptance, unless it expressly states that the bill is to be paid there only and not elsewhere.

(4) Qualified as to " time," i.e. promising to pay at a different time from that mentioned in the bill.

(5) Qualified as to parties, i.e. where it is the acceptance of some one or more of the drawees, but not of all.

The holder of a bill has a right to require an unqualified acceptance and, if he does not obtain it, he may treat the bill as dishonoured for non-acceptance. But if he takes a qualified acceptance, and does not obtain the consent of the drawer or an endorser to the qualification, the drawer and the endorser are discharged.

A person's name may be inserted therein, to whom the holder may resort *in case of need*, i.e. if the bill is not accepted. Such a person is called " *Referee in case of need.*" But it is at the option of the holder to resort to the referee or not, as he may think fit.

(Examples of acceptances are shown on p. 396.)

NEGOTIATION.—A bill is negotiated when it is transferred from one person to another in such a manner as to constitute the transferee the holder of the bill. Every bill is negotiable unless it contains words showing in clear and unequivocable terms that it should not be transferred.

EXAMPLES OF ACCEPTANCES

(1)	*Accepted payable at Lloyds Bank.* *Wm. Johnson.*	(1) General Acceptance (i.e. assents without qualification to the order of the drawer).
(2)	*Accepted payable on delivery of B/L at Lloyds Bank.* *Wm. Johnson.*	(2) Conditional (i.e. payment by the acceptor is dependent on the fulfilment of a condition).
(3)	*Accepted for £90 only.* *Wm. Johnson.*	(3) Partial (i.e. an acceptance to pay part only of the amount for which the bill is drawn).
(4)	*Accepted payable at Lloyds Bank and there only.* *Wm. Johnson.*	(4) Local (i.e. an acceptance to pay only at a particular specified place).
(5)	*Accepted payable in 4 months.* *Wm. Johnson*	(5) Qualified as to time, the Bill being drawn at 3 months.

Nos. 2–5 are all examples of Qualified Acceptances.

A negotiable bill may be payable either—

(1) To bearer, (2) To order.

A bill is payable to bearer—

(*a*) if it is expressed to be so payable; or

(*b*) if the only or last endorsement upon the bill is an endorsement in blank.

In all other cases, the bill is payable to order.

Where a bill is not payable to bearer, the payee must be named or otherwise indicated thereon with reasonable certainty. But where a payee is either—

(1) a fictitious person; (2) a non-existing person, the bill may be treated as payable to *bearer*.

A *non-existing person* means a person who has no real existence, and it is immaterial whether or not the drawer of the bill at the time when he draws the bill believes and intends the bill to be payable to the order of a real person.

A *fictitious person* means not necessarily a person who has never really existed, but a feigned or counterfeit person (i.e. a person who has not, nor was intended by the drawer to have any rights upon or arising out of the bill, so that his name may properly be said to have been used by way of pretence only).

Endorsements. An endorsement consists of two distinct contracts—

(*a*) It transfers the property in the bill; and

(*b*) it involves a liability on the part of the endorser.

A bill may be endorsed in *blank*, that is, without specifying an endorsee, and the bill then becomes payable to bearer.

A *special* endorsement specifies the person to whom, or by whose order, the bill is to be payable. The bill then becomes payable to the person designated or to his order, and can be negotiated only by his endorsement.

The endorsements are generally written on the back of the bill, but an endorsement on the face of a bill is equally valid. Examples of the different kinds of endorsements are shown on page 406.

A bill endorsed in blank may be treated as payable to bearer, or the holder may convert the blank endorsement into a special endorsement by filling in, above the endorser's signature, a direction to pay the bill to, or to the order of, himself; or to some other person; or by inserting a special endorsement following the

endorsement in blank. A bill endorsed in blank may, therefore, circulate from hand to hand, without any further endorsement, until the blank endorsement is converted into a special endorsement.

According to law, the endorser of a bill, by the mere fact of endorsing it, guarantees the payment of the bill and also undertakes a liability in reference to its acceptance. This liability can be excluded by the use of the words "*without recourse*" or some similar words in the endorsement. The addition of these words is, however, somewhat unpopular, as they are apt to throw a doubt on the solvency of the other parties.

An endorsement must be written on the bill itself or on an "*allonge*," that is, a slip of paper attached to the bill. The first endorsement on the allonge must begin on the bill and end on the allonge, in order to prevent an allonge being taken from one bill and affixed to another.

Presentment for Payment. Presentment is the formal act of bringing a bill of exchange to the notice of the acceptor for payment. It must be made by the holder or by some person authorised to receive payment on his behalf, at a reasonable hour on a business day, at the proper place. A bill is presented at the proper place—

(1) Where a place of payment is specified in the bill and the bill is there presented.

(2) Where no place of payment is specified in the bill, but the address of the drawee or acceptor is given in the bill, the bill is presented there.

(3) Where no place of payment is specified and no address given, and the bill is presented at the drawee's or acceptor's place of business, if known ; and if not, at his ordinary residence, if known.

(4) Where a bill is presented at the proper place, and, after the exercise of reasonable diligence no person authorised to pay or refuse payment can be found there, no further presentment to the drawee or acceptor is required.

(5) Where authorised by agreement or usage, a presentment through the Post Office is sufficient.

DISHONOUR OF A BILL OF EXCHANGE.—A Bill of Exchange may be dishonoured either by non-acceptance or by non-payment. Dishonour by non-acceptance takes place when the bill is duly

presented for acceptance and a proper acceptance is refused or cannot be obtained. Dishonour by non-payment takes place when the bill is duly presented for payment and payment is refused or cannot be obtained, or when presentment is excused and the bill is overdue and unpaid. A person failing to give notice of dishonour, or (in the case of a Foreign Bill) to protest the bill loses his right of recourse against drawer and endorsers.

Where the notice is given by or on behalf of the holder, it also acts for the benefit of subsequent holders and all prior endorsers who have a right of recourse against the party to whom it is given. The following is a specimen form of a Notice of Dishonour—

NOTICE OF DISHONOUR TO DRAWER

(Date and Address.)

Please take notice that a bill for £---- -- -- drawn by you under date the ----- on ----------- and payable -------- has been dishonoured by non-payment (or non-acceptance).

(Signed) J. K.

To Mr. A. B.

A Notice of Dishonour need not be in the words mentioned above; in fact, dishonour need not expressly be mentioned. Sometimes a statement that a bill is *unpaid*, and that the charges or the noting come to so much, is a good notice by implication.

Noting a Bill. An Inland Bill, when dishonoured, is sometimes noted, that is, presented a second time by a notary on the day of its dishonour, or not later than the next succeeding business day. If still unpaid, he affixes his note to that effect, stating the reason of its dishonour; and in a Court of law this is admitted as evidence that the bill was duly presented and dishonoured. It is not, however, imperative to note an Inland Bill, although it is generally considered desirable to do so if recourse is to be had against the drawer or endorser.

Protesting a Bill. A Foreign Bill must be duly protested either for non-acceptance or for non-payment. If it is not so protested, the drawer and endorsers are discharged. A *protest* means a formal notarial certificate attesting the dishonour of a bill.

FORM OF PROTEST

UNITED STATES OF AMERICA,
STATE OF NEW YORK.

On the *18th* day of *September,*

in the year Nineteen Hundred and at the request of the holder thereof, I, THOMAS J. BROWN, a Notary Public of the State of New York, duly commissioned and sworn, did present the original Bill of Exchange or Cheque hereto annexed to

Gilbert & Co.,
at *22 West 36th Street,* *New York City,*

and demanded payment thereof, which *they* refused, saying: *To return the draft as they would remit direct.*

WHEREUPON, I, the said Notary, at the request aforesaid, did PROTEST, and by these presents do publicly and solemnly PROTEST, as well against the drawer, acceptor and endorsers of said Bill of Exchange or Cheque, as against all others whom it doth or may concern, for exchange, or re-exchange and all costs, damages and interest already incurred, and to be hereafter incurred, for want of payment of the said Bill of Exchange or Cheque.

THUS DONE AND PROTESTED, in the City of New York, aforesaid, in the presence of John Smith and Richard Smith, witnesses.

In Testimonium Veritatis.

Seal of Notary.

(Signed) *Thomas J. Brown,*
NOTARY PUBLIC.

It usually contains—

(1) An exact copy of the bill;

(2) A statement of the parties for whom and against whom the bill is protested;

(3) The place and date of the protest;

(4) A statement that acceptance or payment has been demanded by the notary, the answer given (if any), or a notification of the fact that no answer was given or that the drawee or acceptor could not be found;

(5) A reservation of rights against all the parties liable; and

(6) The subscription and seal of the notary.

The usual wording of the protest is found on page 400.

ACCOMMODATION BILL.—An Accommodation Bill is a bill which is signed by the drawer, acceptor, or endorser, without receiving value for the same, and for the purpose of lending his name to some other person. It is sometimes known as a "fictitious bill," a "kite," or a "windmill." So long as no value has been given for such a bill, no party is liable to pay the amount of the bill; but directly value has been given, a holder in due course has a right to proceed against any of the signatories, even though he knows that it is an Accommodation Bill.

TEST PAPER

1. What is a Bill of Exchange? Give an example.
2. Mention some of the advantages of the use of Bills of Exchange in the Home Trade.
3. Enumerate the essentials of a Bill of Exchange.
4. If a Bill of Exchange is lost, is it possible to recover the amount owing?
5. What parties are liable on a Bill of Exchange?
6. What is the difference between an Inland and a Foreign Bill?
7. What is meant by "acceptance of a Bill of Exchange"?
8. Distinguish a General from a Qualified Acceptance.
9. Give three examples of Qualified Acceptances.
10. What is a "referee in case of need"?
11. On 1st January, 19.., Messrs. Middlemiss & Turnbull, of London, sent to S. Macgregor, of Manchester, for acceptance, a Bill of Exchange for £100, dated 3rd January, 19.., and payable three months after date. S. Macgregor duly accepted the draft and made it payable at his bankers, The Staple and Stedfast Banking Co., Ltd., of Stockport.

    Show the form of the Bill as it would appear when returned to Messrs. Middlemiss & Turnbull; and state who is the Drawer, and who is the Drawee; and give the date when the Bill will mature.
12. What is an endorsement?
13. Mention two kinds of endorsements.
14. Where is the proper place for the presentment of a Bill of Exchange?
15. Explain the meaning of a dishonoured Bill of Exchange.
16. Distinguish between noting and protesting a Bill.

CHAPTER XLI

CHEQUES

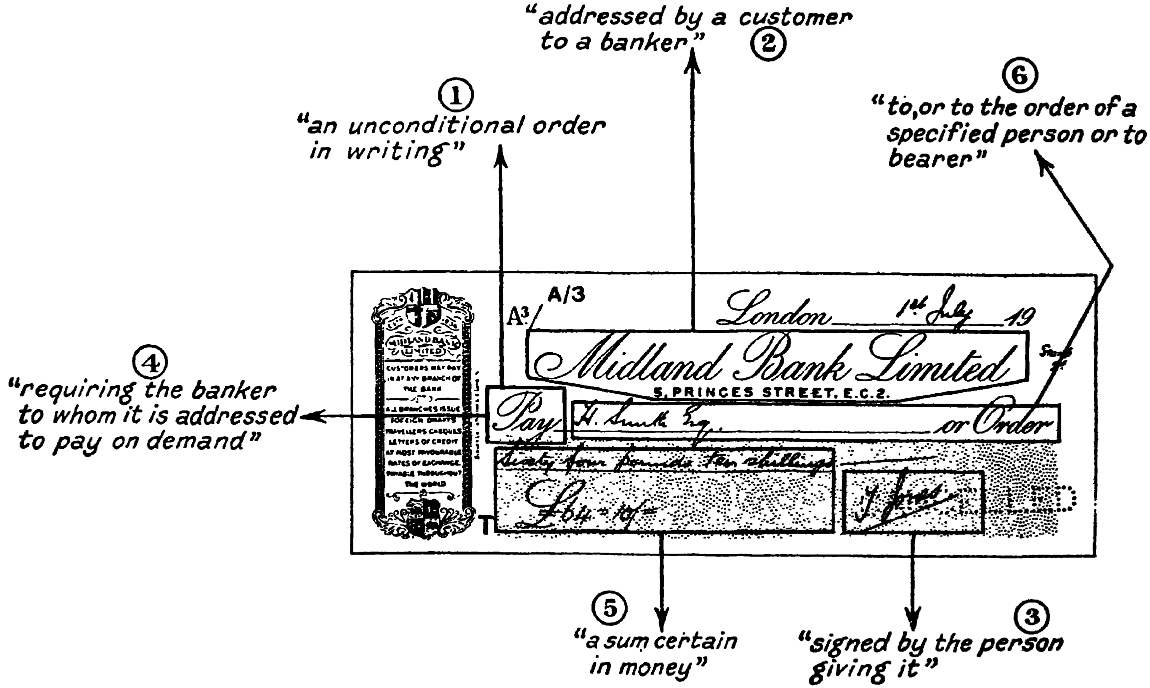
A CHEQUE is a bill of exchange drawn on a banker payable on demand. A cheque, being a bill of exchange, must necessarily be an unconditional order to pay a sum certain in money addressed by one person to another, viz. by the customer to his banker. A copy of a cheque, together with the analysis of its definition, is shown on page 403.

An instrument in the form of a cheque, but made payable only upon signature by the payee on the form of receipt at the foot of the instrument, is not strictly a cheque, because it is a conditional order.

A draft addressed by one bank to another branch of the same bank is not a cheque, since it is not addressed by one person to another.

For the most part, the rules applicable to those bills of exchange which are payable on demand apply also to cheques. No days of grace are allowed for the payment of a cheque, because it is always payable on demand.

Cheques with Endorsed Receipts. Of late years, many companies and other corporations have adopted an order for payment upon their bankers, requiring the payee to sign a receipt which is printed on the back of the cheque. By signing the receipt, the payee acknowledges that the debt of the company or corporation to him is discharged, and he could not afterwards bring an action for the amount. But if he simply endorsed a cheque on receiving payment, that would only prove that he had received a sum of money without showing for what purpose it had been paid. For some time, it used to be doubted whether such orders for payment were strictly cheques, since a condition was imposed of signing a receipt before the money would be paid by the bank. Recent cases, however, seem to show that the condition is not strictly imposed on the banker "not to pay," and, therefore, the order to the banker is unconditional. It has hitherto been a general practice among bankers to require from their customers who adopt cheques of this form an indemnity against any loss they may sustain in dealing with such cheques. The request for the indemnity has proceeded upon the assumption


① "an unconditional order in writing"
② "addressed by a customer to a banker"
③ "signed by the person giving it"
④ "requiring the banker to whom it is addressed to pay on demand"
⑤ "a sum certain in money"
⑥ "to, or to the order of a specified person or to bearer"
A/3
London 1st July 19
Midland Bank Limited
5, PRINCES STREET, E.C.2.
Pay H. Smith Esq. or Order
Sixty four pounds ten shillings
£64 : 10/=

A CHEQUE

that such orders for payment are not cheques in the truest sense of the word. The Cheques Act, 1957, dispenses with the need for endorsing order cheques paid into an account for collection. Drawers of cheques with receipt forms on the back must now indicate by a prominent capital "R" on the face of the cheque that the banker shall look for the receipt on the back.

Bearer Cheques. A cheque is payable to bearer—

(1) When it is drawn payable to a specified person or to bearer, or even when no name is inserted, as: "Pay ------- or bearer."

(2) When the only or the last endorsement is in blank.

(3) When the payee is a fictitious or non-existent person, i.e. when the name has no reference to any particular individual, such as: "Pay Wages." (Some authorities, however, consider such a cheque as payable to the order of the drawer.)

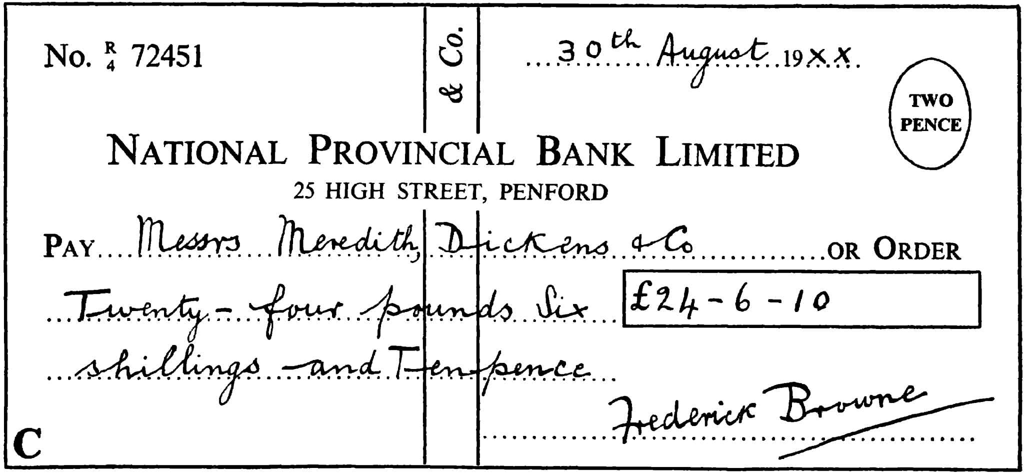
When a cheque is on the face of it payable to bearer, that is, when the word "bearer" appears on the front of the cheque, it cannot, by subsequent endorsement, be converted into an order cheque. The word "Order" printed or lithographed on the cheque forms may be altered into "Bearer" by the drawer, but the alteration must be signed by him.

Order Cheques. A cheque payable to Charles Mitchell without the addition of the words "or Order" may be payable to Charles Mitchell personally without his endorsement. He may, however, endorse, and the effect of the endorsement is then the same as if the words "or Order" had been inserted. If the words "Pay Charles Mitchell only" or "Not Transferable" are put on a cheque, it cannot be paid to anyone else than the payee. These are called *restrictive* endorsements. When the payee of an order cheque writes his name on the back of a cheque, it is then endorsed in blank, and can be passed from one person to another without further endorsement. A blank endorsement may be converted into a special endorsement by writing over the endorser's signature the direction to pay some other person or Order, e.g.—

Pay David Woodhall or Order.

CHARLES MITCHELL.

Charles Mitchell writes his name on the back and passes it to David Woodhall; but, before doing so, he writes: "Pay David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& Co.

30th August 19XX

TWO PENCE

NATIONAL PROVINCIAL BANK LIMITED

25 HIGH STREET, PENFORD

PAY Messrs Meredith, Dickens & Co OR ORDER

Twenty-four pounds Six shillings and Tenpence

£24-6-10

Frederick Browne

C

A CROSSED CHEQUE

EXAMPLES OF ENDORSEMENTS

(1)	*Joseph Shuttleworth.*	(1) Blank Endorsement. A cheque thus endorsed would be payable to "bearer."
(2)	*Pay to the order of Mr. Leo Garner. Joseph Shuttleworth.*	(2) Special Endorsement.
(3)	*Pay to Mr. Leo Garner only. Joseph Shuttleworth.*	(3) Restrictive Endorsement.
(4)	*Per pro. John Hall & Son. Arthur Barr (Cashier).*	(4) *Per procuration* Endorsement.
(5)	*James Kay, sole executor of the late Simon Caton.*	(5) Executor's Endorsement, where there is only one executor.
(6)	*For Self and Co-Executors of Simon Caton. James Kay.*	(6) The signature of one executor suffices to bind the rest.
(7)	*For Leonard Garner. John Taylor, Wm. Hall } Trustees.*	(7) Trustee's Endorsement. In this case, all the trustees would sign.
(8)	HER *Rose* **X** *Martin.* MARK *Witness, John Kay, 40 Walkden Road, Worsley.*	(8) Illiterate's Endorsement.

Woodhall or Order." This will then become a *special* endorsement, because the cheque cannot be passed to anyone else unless David Woodhall's endorsement is there.

Although a cheque is payable to a named person who presents it, the banker takes the precaution of getting his endorsement. If the presenter is not the person named as the payee, and yet puts the payee's name as an endorsement on a cheque, he is guilty of forgery, and it is a forgery, although the name on the cheque is the same as that of the person named as the payee, provided, of course, that there are two different persons of the same name. The endorsement is evidence that the person who has endorsed it has received the cheque or has been paid the money.

The payee's cheque may be either *joint* or *alternative.* An example of the former would be: "Pay Charles Mitchell and Robert Mitchell." Both these persons must then endorse and both receive the money.

But in cases of partnership, one partner may sign for himself and the others. An alternative payee would be: "Pay Charles Mitchell or Robert Mitchell"; and in this case, either may endorse and either may receive the money.

Again, the cheque may be made payable to "A. B., or E. F. or Order," and the same rule will also apply in this case.

Another more obscure endorsement, which is not strictly joint or alternative, arises from: "Pay the Trustees of John James or Order." This cheque must be endorsed by all the trustees, because trustees have no power to delegate their authority to one or more of their number, and each one must give his signature. One executor, however, may endorse for himself and co-executors.

NEGOTIABILITY OF CHEQUES.—A cheque can be negotiated like a bill of exchange, viz. by mere delivery, if payable to bearer; or by delivery, plus endorsement, if payable to order.

On the other hand—

(1) Cheques are never accepted by the drawee as in the case of bills of exchange. Hence, the holder of a cheque cannot sue the banker on whom it is drawn.

(2) Notice of dishonour to the drawer of a cheque is rarely necessary, because it is excused by the absence of any money belonging to the drawer in the hands of the drawee, which is the usual cause of the dishonour of a cheque.

(3) Cheques are not intended for circulation, as is the case with bills of exchange. Hence, a cheque must be presented for payment within a reasonable time of its issue; and in determining what is a reasonable time, regard must be had to—

(*a*) the nature of the instrument;
(*b*) the usage of trade and of bankers;
(*c*) the facts of the particular case.

PRESENTMENT FOR PAYMENT.—In ordinary cases, if the receiver of a cheque and the banker on whom it is drawn are in the same town, it ought to be presented during the next day; and if they are in different towns, it ought to be forwarded for presentment during the next day and presented by the person to whom it is so forwarded within the day after he receives it. Cheques are usually treated as "stale" if not presented for payment within six months of their date. That is to say, the drawer is referred to for instructions as to whether the cheque is to be paid or not.

So long as the balance of an account is in the favour of his customer, a banker is bound, at his peril, to pay all cheques drawn by his customer; and if he fails in his duty, an action will lie against him, even though the customer has sustained no actual loss or damage in consequence of the dishonour of his cheque.

Payment by cheque is equivalent to payment in cash, subject to the condition that, if a cheque is stopped or dishonoured, the right of the creditor to receive payment in cash is revived.

If a cheque is sent by post in a letter properly addressed to a creditor and is lost in transmission, the debtor is discharged if he was directed by the creditor so to transmit the money, but not otherwise; and the mere fact that the debtor was following the usual course of dealing between the parties is not of itself sufficient to discharge him.

COUNTERMAND OF PAYMENT.—The duty and authority of a banker to pay a cheque drawn on him by his customer are determined by—

(1) Countermand of payment, which is usually called stopping a cheque. But in order that a countermand may be effective, there must be not only a change of purpose on the part of the customer, but also a notification of that change to the banker; and, although a telegram countermanding a cheque may reasonably be acted upon by a banker at least to the extent of postponing

the honouring of a cheque until further inquiry can be made, yet a banker is not bound to accept an unauthenticated telegram as sufficient authority for the serious step of refusing payment.

(2) Notice of customer's death.

(3) Notice that the customer has committed an available act of bankruptcy.

(4) The receipt of a garnishee order.

FORGED SIGNATURES OF DRAWER.—Where a signature on a bill, cheque, or note is forged or placed thereon without the authority of the person whose signature it purports to be, the forged or unauthorised signature is wholly inoperative and no right either—

(*a*) To retain the bill, cheque, or note ; or

(*b*) To give a good discharge therefor ; or

(*c*) To enforce payment thereof against any party thereto can be acquired through or under that signature, unless the party against whom it is sought to retain or enforce payment of the bill, cheque, or note is precluded from setting up the forgery or want of authority. Hence—

(1) A banker who pays a cheque to which the drawer's signature has been forged cannot debit it to his customer's account.

(2) A banker who pays a cheque, the amount of which has been fraudulently altered or erased, can charge his customer only with the amount originally placed thereon, unless the customer has been so negligent in the discharge of some duty he owes to the banker as to be estopped from setting up the forgery as a defence. The extent of such duty depends upon the contract between the parties, whether expressed or implied from an established course of dealing between them ; but in 1918, the House of Lords held that if a customer of a bank draws a cheque in a manner which facilitates fraud, he is guilty of a breach of duty as between himself and the banker, and is responsible for any loss suffered by the banker as a consequence.

If a person signs his name on a blank stamped piece of paper and entrusts the paper to another person with authority to fill it up as a bill, cheque, or note for a certain amount, and that person fraudulently fills it up for a larger amount, the person first named will be estopped as against a bona fide holder for value of the instrument from denying the validity of the instrument, and will be liable for the full amount appearing on the face of the instrument.

FORGED ENDORSEMENTS.—The liability of a banker in the case of his paying a cheque bearing a forged endorsement was formerly the same as when he paid a cheque to which the drawer's signature was forged. But this was a hardship upon the bankers, because, while they may be expected to know their customers' signatures as drawers, they cannot possibly know the signature of every payee or endorsee, who may be entire strangers to them.

By the Bills of Exchange Act, 1882 (Sect. 60), when a bill payable to order on demand is drawn on a banker, and the banker on whom it is drawn pays the bill—

(1) In good faith; and (2) In the ordinary course of business; it is not incumbent on the banker to show that the endorsement of the payee, or any subsequent endorsement, was made by or under the authority of the person whose endorsement it purports to be; and the banker is deemed to have paid the cheque in due course, although such endorsement has been forged or made without authority. But the provisions of this section of the Bills of Exchange Act have no application to—

(1) Forgeries of the drawer's signature.

(2) Any kind of instrument except a bill payable on demand drawn upon himself, which is a cheque.

Hence a banker who pays any other kind of bill on the strength of a forged endorsement is still prima facie liable for any loss resulting therefrom.

(3) Any person other than the one on whom the cheque is drawn. Hence a third party who cashes a cheque bearing a forged endorsement, whether a banker or a private individual, is still prima facie liable to refund to the drawer the money received on the cheque from the banker on whom it is drawn.

CROSSED CHEQUES.—A cheque may be crossed either—

(1) Generally; or (2) Specially.

A cheque is crossed generally when it bears across its face an addition of either—

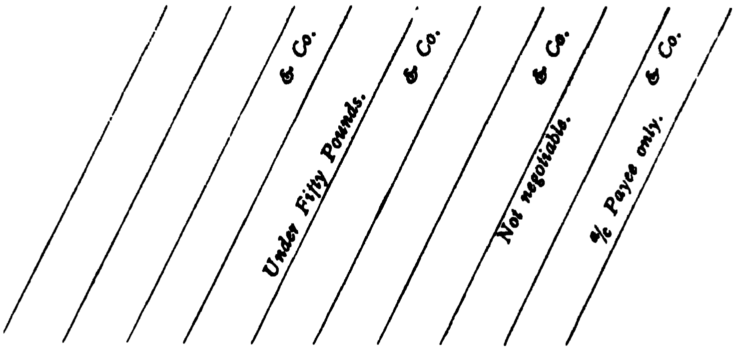
(*a*) The words "and Company," or any abbreviation thereof, between two parallel transverse lines; or

(*b*) Two parallel transverse lines simply.

A cheque is crossed specially when it bears across its face an addition of the name of a banker, in which case it is said to be crossed specially to the particular banker whose name appears on its face.

The following are examples of the different kinds of crossings—

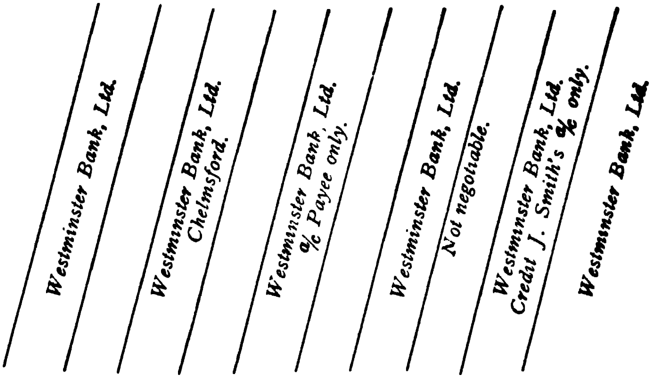
(*a*) *General Crossings*



(1) (2) (3) (4) (5)

(*b*). *Special Crossings*

These are as under—



(6) (7) (8) (9) (10) (11)

A crossing may be added to an uncrossed cheque by either the drawer or any holder of the cheque, either of whom may turn a general into a special crossing.

Not Negotiable Crossing. If and when a cheque is crossed, whether the crossing is a general or a special one, but not otherwise, it may also have the words " Not Negotiable " written across the face of it either by—

(1) The drawer; or

(2) Any holder of the cheque.

The effect of having the words "Not Negotiable" upon a cheque is that, although the cheque continues to be as freely transferable or assignable from one person to another as if those words had not been added, it ceases to be negotiable at all; and, therefore, a person who takes a crossed cheque which bears across its face the words "Not Negotiable," cannot have, and he is not capable of giving, any better title to the cheque than the person from whom he took it had.

RIGHTS AND DUTIES OF THE PAYING BANKER.—Where either—

(1) An uncrossed cheque; or

(2) A cheque crossed generally is sent to a bank for collection, the collecting banker may cross it specially to himself; and where a cheque is crossed specially, the banker to whom it is crossed may again cross it specially to another banker for collection. The general effect of crossing a cheque is to prevent its being paid except through the medium of a banker, because by the Bills of Exchange Act, 1882 (Sect. 79), where a banker on whom a crossed cheque is drawn, pays it—

(*a*) If crossed generally otherwise than to a banker; or

(*b*) If crossed specially, otherwise than to the particular banker to whom it is crossed, or to his agent for collection, being a banker;

he is liable to the true owner of the cheque for any loss he may sustain in consequence of the cheque having been so paid.

On the other hand, where the banker on whom a crossed cheque is drawn, in good faith and without negligence, pays it—

(1) If crossed generally, to a banker; or

(2) If crossed specially, to the particular banker to whom it is crossed, or to his agent for collection being a banker; then both—

(*a*) The banker paying the cheque; and

(*b*) The drawer of the cheque, IF *the cheque has actually come into the hands of the payee;*

are respectively entitled to the same rights and to be placed in the same position as if payment of the cheque had been made to the true owner.

RIGHTS AND DUTIES OF COLLECTING BANKER.—Inasmuch as

payment of a crossed cheque can be obtained only through the medium of a banker, it is only fair that a banker who collects a crossed cheque for a customer pursuant to a duty imposed upon him by law, should have a corresponding protection given to him by law while acting in the discharge of that duty.

Hence, by the Bills of Exchange Act, 1882 (Sect. 82), where a banker in good faith and without negligence receives payment for a customer of a cheque which is crossed either generally or specially to himself, and the customer has no title or only a defective title thereto, the banker will not incur any liability to the true owner of the cheque by reason only of having received such payment. Section 82, however, applies only to cheques which are crossed before they come into the banker's possession; and the banker cannot, by afterwards crossing the cheque himself, become entitled to the protection given by the section.

In order that a collecting banker may be entitled to the benefit of Section 82, it is essential—

(1) That he should act in good faith and without negligence.

(2) That the person for whom he collects the cheque should be his customer, that is to say, a person between whom and himself there is some sort of account—though it is immaterial whether it is a current account or deposit account—or, at any rate, some similar relation.

The protection given by this section has been eaten into by various legal decisions, and little real protection is left to a banker collecting a third-party cheque.

PROMISSORY NOTES.—A *Promissory Note* is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay either—

(1) On demand; or

(2) At a fixed or determinable future time, a sum certain in money either to or to the order of a specified person, or to bearer.

A note which is, or on the face of it purports to be, both drawn and payable within the British Islands, is an inland note. Any other note is a foreign note. Except as hereinafter mentioned, the provisions of the Bills of Exchange Act, 1882, relating to Bills of Exchange, apply with the necessary modifications to notes; e.g.—

(1) They are fully negotiable instruments;

PROMISSORY NOTE

6d

£50-0-0

63. Wormwood Street
London, E.C. August 15/14

Four months after date I promise to pay to Mr Harold Jeffery the sum of Fifty Pounds for value received.

(2) They can be negotiated by delivery with or without endorsement, as the case may be;

(3) The same days of grace are allowed; and

(4) Just as in the case of inland bills, so the paper on which inland notes are written must be previously stamped.

DIFFERENCE BETWEEN PROMISSORY NOTES AND BILLS OF EXCHANGE.—There are three points in which notes differ from bills, viz.—

(1) The stamp duty is *ad valorem* whether the note is payable on demand or otherwise.

(2) Whereas a bill has three original parties, viz. the drawer, drawee, and payee, a note has only two original parties, viz. the maker and payee.

(3) Whereas a drawer of a bill is only secondarily liable by way of surety to the acceptor, the drawer, or maker of a note is the person primarily liable, because the maker of a note, by making it, engages that he himself will pay it according to its tenor.

Hence, in applying the provisions of the Bills of Exchange Act to Promissory Notes, two points must be borne in mind—

(1) The maker of a note is deemed to correspond not with the drawer, but with the *acceptor* of a bill.

(2) The first endorser of a note is deemed to correspond with the drawer of an accepted bill payable to the drawer's order.

On the other hand, the following provisions of the Act relating to bills do *not* apply to notes—

(1) Provisions as to acceptance, including presentment for acceptance and acceptance *supra protest*, because a promissory note is never accepted.

(2) Provisions as to bills in a set, because the practice of drawing notes in a set is unknown.

(3) The protesting of foreign bills, because when a foreign note is dishonoured, the protest thereof is unnecessary.

Joint and Several Promissory Notes. A promissory note may be made by two or more makers, and they may be liable thereon either—

(1) Jointly; or (2) Jointly and severally.

But where a note runs: "I promise to pay," and is signed by two or more persons, it is deemed to be their joint and several note.

Presentment for payment is always necessary to render an endorser of a note liable; but it is not necessary in order to charge the maker of a note, except where the note is made payable at a particular place.

JOINT AND SEVERAL PROMISSORY NOTE

> Stamp 1/
>
> £85:0:0 — 25 Gracechurch Street, London E.C. August 15th 19
>
> Three months after date we jointly and severally promise to pay to John Robinson or order the sum of Eighty Five pounds for value received.
>
> Ernest Roberts.
> James Brown

"I OWE YOU."—An instrument which is sometimes confused with a promissory note is an I O U, but the essential difference between the two is that a note is a negotiable instrument, whereas an I O U is not; that is to say, the rights arising under an I O U can only be assigned from one person to another under and subject to the conditions of the Judicature Act, 1873.

An I O U is a mere acknowledgment in writing of a debt due from the person who gives it, to the person to whom it is given. But although it is evidence of some debt being due, it is not evidence of the nature of the debt (e.g. whether it was for money lent or for goods supplied, or for services rendered or otherwise).

An I O U in the ordinary form does not require any stamp ; but—

(1) If it contains an agreement that it is to be paid on a fixed day or on demand, it will amount to a promissory note, and must be stamped as such ; and

(2) If the words used are such as to make it not a promissory note, but an ordinary contract to pay money, it must be stamped with a sixpenny agreement stamp, unless it is under £5 in amount.

TEST PAPER

1. Is a draft by a Bank to its Branch, a cheque ? Give reasons for your answer.

2. What is the effect of " crossing " a cheque, and what is the difference between a cheque made payable to Tom Jones or " order " and one payable to Tom Jones or " bearer " ?

3. What is a restrictive endorsement ?

4. How may a blank endorsement of a cheque be converted into a special endorsement ?

5. Draw a cheque on the Westminster Bank, Ltd., in settlement of an account. Cross it generally and mark it " Not negotiable." Explain the effect of the last two words.

6. How does the negotiability of a cheque differ from that of a Bill of Exchange ?

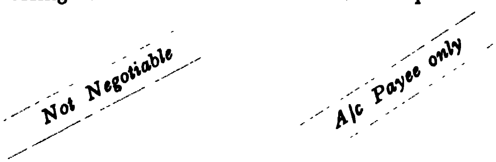
7. When should a cheque be presented for payment ?

8. What authority has a banker to stop payment of a cheque ?

9. Explain the following terms—

Bearer	Special Endorsee
Holder in due course	Acceptor *supra protest*

10. Explain and contrast the advantages or disadvantages of the understated crossings as used in connection with cheques—



11. What is meant by " crossing " a cheque, and why is it resorted to ? Give three different specimen crossings, and explain the meaning of each. If you received an open cheque made out in your name and payable to bearer, what precautions would you adopt to prevent its being wrongfully cashed ?

12. What is the effect of crossing a cheque " Not Negotiable " ?

13. What are the rights and duties of the " paying banker " ?

14. What is the effect of a forged or unauthorised signature on a cheque ?

15. Explain the terms—

General crossing. *Collecting banker.* *Forged endorsement.*

16. What special rules apply to bankers in dealing with crossed cheques ?

17. What is the difference between a Promissory Note and a Bill of Exchange ?

18. What is a Joint and Several Promissory Note ?

19. A B owes C D £100, payment of which the latter agrees to allow to stand over for six months on receiving interest at £4 per cent per annum. Draw up a promissory note to carry out this arrangement.

20. Messrs. J. Jones & Co., Ltd., Cardiff, owe to Messrs. T. Williams & Son, Newport, £350.

(*a*) Draw a cheque on Lloyds Bank, Ltd., dated 1st April, to discharge this debt. Cross the cheque specially.

(*b*) Draw a bill of exchange, dated 1st April, payable in three months after date to discharge the same debt. Show the acceptance of the bill.

Point out as many differences in the two forms of payment as you can.

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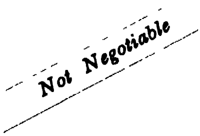

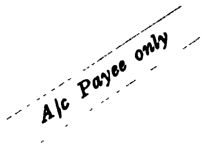

11. What is meant by " crossing " a cheque, and why is it resorted to ? Give three different specimen crossings, and explain the meaning of each. If you received an open cheque made out in your name and payable to bearer, what precautions would you adopt to prevent its being wrongfully cashed ?

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Point out as many differences in the two forms of payment as you can.

CHAPTER XLII

THE BANKERS' CLEARING HOUSE

THE amount of money which changes hands daily in the City of London averages over 500 millions of pounds sterling in cheques and bills, exclusive of cash payments; and the value of the English banking facilities will be further understood when it is learned that this sum is passed from hand to hand without the handling of a single coin of the realm. This is made possible by the existence of the London Bankers' Clearing House, through which pass the majority of the cheques drawn on banks in England and Wales.

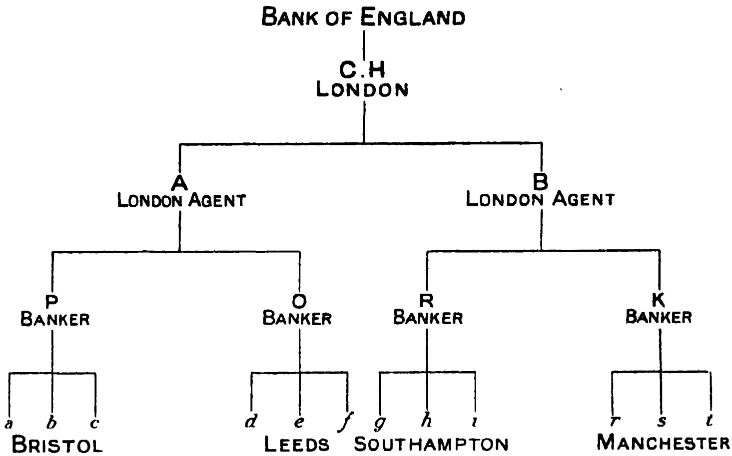
THE CLEARING HOUSE SYSTEM.—This system appears to have arisen in an unofficial manner, concurrently with the use of cheques and the growth of deposit banking in London. Every day clerks had to go round to each of the other banks to present cheques and bills upon them and bring back the proceeds. It soon became evident that much time could be saved if, instead of going to each bank separately, they were to meet in one central place and make their settlements together. The practice of doing so appears to have begun about 1770. The development of this system justified the building of a Clearing House in Post Office Court, Lombard Street, in 1833. Originally thirty-nine private banks combined in this arrangement, and it was not until 1854 that the joint stock banks obtained admission. By the end of the nineteenth century, however, the number of private banks had so diminished—due partially to the failure of some of the larger Houses in successive banking panics and crises—that the joint stock banks had become the owners of the Clearing House. These banks carried with them the development of the system of payment by cheque; until at the present time the volume of commercial transactions carried out purely by cheque is many times as great as that completed in notes and coin.

The Clearing House itself is regulated by rules which are drawn up by a committee of members, and administered impartially by the officers, viz. the chief inspector, the deputy inspector, and the assistant, all of whom are appointed by the committee.

Each clearing bank has an account with the Bank of England, where the "Account of the Clearing Bankers" is also kept. At

the close of each day's business, when the balance due to or from the Clearing House in respect of each individual bank has been ascertained, the amount is transferred to or from the "Account of the Clearing Bankers," and the account of the individual bank.

PRINCIPLE OF CLEARING.—In the diagram below, let A be the London agent of P and O; B the London agent of R and K, C. H. representing the London Clearing House. If *b*, a customer of P in Bristol, sends a cheque to S, a customer of K in Manchester, S would pay the cheque into K for collection; K would



then credit S with the amount, and forward the cheque to the London agent B, who would debit A and credit K, presenting the cheque on A through the Clearing House. A would then debit P and credit B, forwarding the cheque to P by the next post; P, on receiving the cheque, would debit his customer *b*, and credit the Agent A, the transaction again being closed.

Thus, since every London bank has a running account with the Bank of England, the balance to be paid from one bank to another on each day's clearing is settled by a cheque on the Bank of England, where a simple transfer in the books from one account to the other closes with simplicity and perfection all the daily payments made from one part of the kingdom to another.

CLEARING BANKS.—In 1854 payment of differences in money as

between bankers was abandoned and an account was opened by each member bank at the Bank of England. In 1858 country cheques (except certain local ones) came to be passed through the London agent of the country bankers. In 1864 the Bank of England joined the Clearing House.

In addition to cheques, bills of exchange and promissory notes in London (but not country bills or notes) are free to pass through the Clearing House. In addition to the "Big Five" the present members of the Clearing House are the Bank of England, the National Bank, Martins Bank, Coutts & Co., Glyn, Mills & Co., Williams Deacon & Co., and the District Bank. The Bankers' Clearing House Returns form a valuable indication of the conditions of trade. As our internal transactions in trade are completed by means of bills and cheques, the range of clearing, as it is termed, furnishes a direct indication of the volume of those transactions—that is, of the activity or depression of trade, due regard being had to the effect of changing price levels.

In addition to the London Clearing House there are provincial clearing houses at Birmingham, Bradford, Bristol, Hull, Leeds, Leicester, Liverpool, Manchester, Newcastle, Nottingham, Sheffield, and Southampton. Each one clears cheques within its own town and the area surrounding it.

The settlement of mutual dealings through the London Clearing House is dealt with by means of summarised sheets, i.e. printed lists with debit and credit columns showing the liabilities of the individual banks to the bank whose name appears at the head of its own list.

Prior to the Second World War, there were four clearings each day. These were—

(1) **Metropolitan**—cheques drawn on the branches of Clearing Banks situated in London, but outside the area of the Town Clearing.

(2) **First Town Clearing**—cheques drawn on the Clearing Banks and received since the closing of the Clearing House of the previous day.

(3) **Country Clearing**—cheques drawn on country banks.

(4) **Second Town Clearing** (the busiest of all)—cheques drawn on members of the Clearing House and paid in during the morning, and also cheques received from suburban and branch banks during the morning.

The Metropolitan and Country Clearings have now been combined

SPECIMEN CLEARING TRANSACTION

Example—

		£		£
A owes	to B	300,	to D	400
B "	" C	100,	" D	100
C "	" D	250,	" A	100
D "	" B	60,	" C	40

(In the Books of the Clearing House)

A

Dr.	£	Cr.	£
To B .	300	By C .	100
" D .	400	" Bal.	600
£	700	£	700
To Bal.	600		

B

Dr.	£	Cr.	£
To C .	100	By A .	300
" D .	100	" D .	60
" Bal.	160		
£	360	£	360
		By Bal.	160

C

Dr.	£	Cr.	£
To D .	250	By B .	100
" A .	100	" D .	40
		" Bal.	210
£	350	£	350
To Bal.	210		

D

Dr.	£	Cr.	£
To B .	60	By A .	400
" C .	40	" B .	100
" Bal.	650	" C .	250
£	750	£	750
		By Bal.	650

CLEARING HOUSE SUMMARY

	Debtors £		Creditors £
Summary Sheet { A .	600	B . . .	160
C .	210	D . . .	650
	£810		£810

(In the Books of the Bank of England)

GENERAL CLEARING HOUSE ACCOUNT

Dr.	£	Cr.	£
To B . .	160	By A . .	600
" D . .	650	" C . .	210
	£810		£810

CLEARING BANKERS ACCOUNTS

A

Dr.	£	Cr.	£
To C. H. A/c. .	600		

B

Dr.	£	Cr.	£
		By C.H. A/c. .	160

C

Dr.	£	Cr.	£
To C.H. A/c. .	210		

D

Dr.	£	Cr.	£
		By C.H. A/c. .	650

The amount of £810 is not paid in cash but the accounts of B and D are credited in the books in the Bank of England, whilst those of A and C are debited. For these amounts special tickets are issued, white tickets for credits and green for debits. Both tickets are signed by an Inspector at the Clearing House to certify their correctness.

The above example is an attempt to illustrate the economy of time and effort resulting from the operations of the Clearing System. Instead of currency changing hands, debts are set-off against one another through the Bank of England.

with a large part of the Town Clearing, and there are two clearings—"Town" and "General."

Each Clearing Bank has an account at the Bank of England, and there is also a general account known as the Clearing Bankers' Account. If, on any day, a bank is indebted to the others on balance, a white ticket is made out to effect a transfer from its account at the Bank of England to the Clearing Bankers' Account. If, on the other hand, it is in credit, a green ticket is used to authorise a transfer from the Clearing Bankers' Account to the bank's own account at the Bank of England. Both tickets are signed by an inspector at the Clearing House to certify their correctness. If there are any "returns," i.e. dishonoured cheques, they are sent back to the Clearing House before 4.10 p.m. on the day of exchange if they are London cheques. Country cheques, however, are returned by the paying banks direct to the bankers who are collecting them, and a settlement in respect of such cheques is made without subsequent resort to the Clearing House, though the London agents have to be informed of the fact of dishonour. A specimen transaction is shown on page 421.

Clearing houses similar to those of the provinces exist in Scotland and Ireland, and in Scotland a considerable number of the notes issued by the Scottish banks are passed through in addition to cheques.

OTHER CLEARING HOUSES.—The clearing system has been found advantageous in several other circles apart from banking. For example—

(*a*) The London Produce Clearing House regulates bargains in foreign and colonial produce, such as tea, coffee, wheat, and other products.

(*b*) The Cotton Clearing House at Liverpool deals specially with the trade in raw cotton.

(*c*) The Stock Exchange Clearing House eliminates all intermediary buyers and sellers of securities in the course of a fortnightly account, and ultimately reveals the original sellers of stock and the eventual buyers.

The profits or losses made by intermediate dealers are settled by means of "differences." All clearing methods are of service to the community because they vastly reduce the amount of circulating media required by the community.

TEST PAPER

1. Explain the reason why so much business is effected on such a small cash basis.

2. Into what two classes are the London Clearings divided?

3. Copy the diagram on page 419 and explain carefully its meaning.

4. Mr. Jones, who banks with Thompson & Co., buys goods from Mr. Brown, who banks with Williams & Co., and pays for them with a cheque. Explain the nature of that cheque; and trace its life-history from the time when it is signed by Mr. Jones to the time when it returns to him with his pass-book statement.

5 Show by simple illustrations, the economy of time and labour effected by the use of the bankers' clearing houses. If there take place a large increase in the trade of the country, and a steady fall in wholesale prices, how would you expect these factors to be shown in the figures of the bank clearing?

6. A B, who has a banking account with Barclays Bank, Threadneedle Street, London, hands a cheque for £100 to C D, who banks with Lloyds Bank, Cornhill, London. State as clearly and fully as possible what happens to this cheque, and through whose hands it passes. In what respect, if any, would your answer have been different if A B had his banking account with the Bank of England?

7. Give a simple illustration of the work of a bankers' clearing house. What deductions can be drawn from changes in the periodic figures of total clearings?

CHAPTER XLIII

THE FOREIGN EXCHANGES

FOREIGN Exchange may be defined as that section of commerce which deals with the means and methods by which rights to wealth expressed in the currency of one country are translated into rights to wealth in terms of another country's currency. It is simply an extension of the internal credit system to the wider field of international trade, and is rendered necessary by the existence of different national monetary systems. If we have a group of countries each member of which defines the value of its unit of account in terms of the same metal, say gold, then it would be possible for international indebtedness to be settled by the transmission of gold from debtor to creditor. This method of paying debts would be both inconvenient and expensive, and has, in modern times, accounted for only a very small fraction of international payments. The system of the foreign exchanges provides a means for the settlement of indebtedness between traders in different countries, not by the transfer of metallic money, but by the use of credit instruments. Debts and credits which are near together are made to settle debts and credits which are far apart. Indeed, foreign exchange has been described as the sale of bank deposits in one country in order to acquire control of bank deposits abroad.

The basis of this international indebtedness is foreign commerce, which may assume a number of different forms, the chief of which are—

(1) Payments for the imports and exports of commodities, that is, raw materials and finished goods, which pass between one country and another.

(2) Payments for services rendered, such as transport, banking, insurance, or the provision of tourist facilities.

(3) The making of loans to foreign governments and other bodies, and the repayment of principal and interest.

(4) Investment in industrial and commercial enterprises abroad and the payment of dividends.

(5) Purchase and sale of stock exchange securities of international importance.

THE MACHINERY OF SETTLEMENT.—So far as the internal trade of a country is concerned, a debtor may pay his creditor either by the use of legal tender money or by the use of some credit instrument such as a cheque. When we come to the question of foreign trade, however, ordinary legal tender money cannot be used, so that we are compelled either to find some commodity which is acceptable, such as gold, or to deal in credit instruments through some international clearing system. The use of bullion for this purpose has practically been abandoned for reasons which the following example

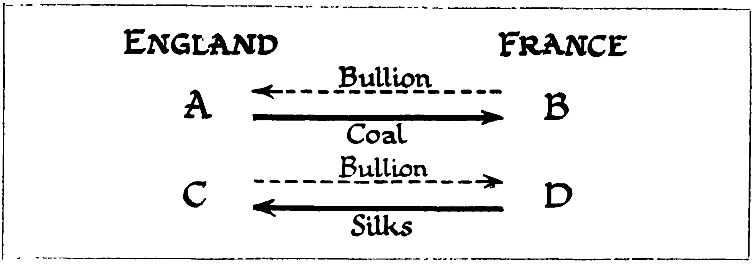


FIG. 1. PAYMENT WITH BULLION

will make plain. Suppose, as in Fig. 1, that A in England, is creditor to B in France for a certain sum; suppose that D in France is creditor to C in England for an equal sum; then, in order to pay their debts by this method, B would have to send bullion to A, and C would have to send an equal sum to D, thus causing two separate transmissions of bullion between England and France at considerable expense to both parties.

Let us now imagine that a bill of exchange is introduced into the transaction as in Fig. 2. B gives his acceptance to A for the amount of the debt, and the latter sells the bill to C. A has now received his money and drops out of the transaction. C, in turn, sends the bill to D in France in settlement of his debt, and D presents it to B for payment. Thus, under this arrangement, C pays A in England, and B pays D in France, with a saving of trouble and expense to all parties. We may imagine a bank or a bill broker acting as an intermediary in both countries in order to establish contact between the parties.

Even in the latter example, however, we have made an assumption which is highly improbable, namely, that the debt between A and

B is exactly equal to that between C and D, so that the bill can be transferred from A to C. In order to overcome this difficulty, let us carry the argument a stage further. Suppose that the English bank buys remittances from France from all those who wish to sell them and pays out sterling for them. The remittances are sent to France, either to a branch or a correspondent bank, and the proceeds, in francs, when collected, are credited to the English bank's account in France. If, now, other customers in England wish to pay debts in France, the English bank can sell to them, in exchange

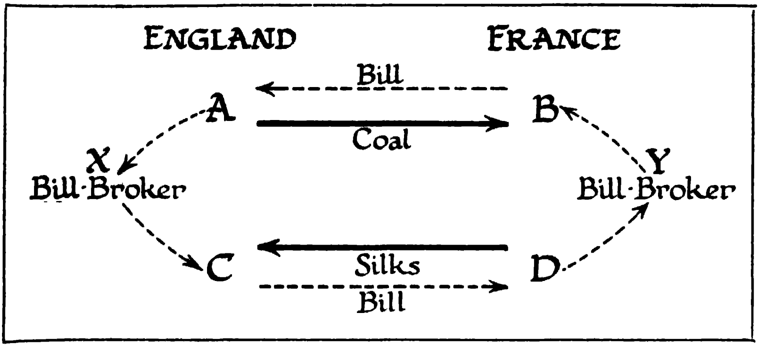


FIG. 2. PAYMENT WITH BILL OF EXCHANGE

for sterling, claims in francs drawn upon the account which has been built up in France. In like manner, the French correspondent bank will maintain a sterling account and will act in the same way, so that between them they provide a clearing house for the settlement of Anglo-French debts.

STERLING BILLS.—Prior to the first World War this country exported its goods widely throughout the world, and bills drawn on London were readily available and readily accepted because of the strength and integrity of the money market in this country. Although our exports are less universally spread now, the sterling bill still plays a paramount role in the settlement of international debts. Sterling currency is used to settle trading debts of all the countries in the Sterling area. These are at present all the countries in the Commonwealth (except Canada), Burma, Iceland, Iraq, the British Protected States in the Persian Gulf, the Irish Republic, Jordan and Libya. These countries contain one-quarter of the world's population and do one-quarter

of the world's trade. Since trade within this area can be carried on in sterling and without exchange control licensing problems, and since so much of world trade is done with this area, it is not surprising that the sterling bill still holds a leading position in the world bill markets.

METHODS OF REMITTING FUNDS.—We have already defined the business of foreign exchange as being concerned with the settlement of foreign debts by the use of credit instruments. For this purpose, foreign exchange dealers have evolved a number of different types of remittance, which differ one from the other mainly in the speed with which they can be converted into cash, and the risks to which they expose the user. The following are the principal types—

(1) **Telegraphic or Cable Transfers.** These are orders for the payment of foreign currency which are sent by telegraph or cable. They may be used when it is desired to settle obligations in foreign money immediately, and thus avoid the delays incidental to sending remittances by mail. Sterling is paid into the bank when the order to make payment is given, and the foreign currency is paid over to the creditor on the same day. Such a method of payment obviously can be used only between institutions holding funds on deposit with one another. Further, an elaborate system of authenticating cables must be devised in order to avoid the possibility of fraud, and this is possible only between banks with working agreements. The telegraphic transfer is the safest and most convenient mode for the transmission of funds, and therefore commands the best rate. Indeed, the T.T. rate is the basic rate of exchange between two currencies.

(2) **Mail Transfer.** This is an order sent by one bank to another, by mail, instructing it to pay over a sum in currency to a third party and debit the bank's currency account with the amount and the charges. In effect, this instrument operates in the same way as a cheque, but since it is not negotiable or transferable, there is no stamp duty, and there is no risk of loss. Payment of funds in the foreign centre will, however, be delayed until the arrival of the instrument, so that some allowance must be made in the rate for loss of interest.

(3) **Guaranteed Mail Transfer.** This is an instrument of comparatively recent origin designed to remove the element of uncertainty as to the time of payment associated with the use of a mail transfer.

Payment of a mail transfer cannot be made prior to the arrival of the instrument itself, so that an unexpected delay in the mail will upset the basis of the allowance for loss of interest to the detriment of one or other of the parties. In order to make the date of payment of the funds in the foreign centre certain, the guaranteed mail transfer is employed, which is sold with an undertaking that the funds shall be paid over on a stated date, irrespective of the arrival of the mail. Instructions are sent to the bank overseas by "deferred" cable, that is, during slack hours, at cheaper rates.

(4) **Stock Draft.** This is a draft drawn by a seller of stock exchange securities in the home centre upon the buyer abroad. The relevant securities are attached to the draft so that the purchasing bank has a lien on them for the amount of the draft as well as preserving its right of recourse against the customer as drawer of the draft. Suppose, for example, that a firm of London stockbrokers makes a purchase of shares on behalf of a client in New York. They draw on him for the amount of the purchase and sell the draft to a London bank with the stock certificates attached. The London bank collects the amount of the draft in dollars for the credit of its account in New York. If the reverse transaction takes place, the buyer in London may make arrangements with his bank to pay over to the seller of shares in New York the amount of the transaction in dollars against delivery of a draft with certificates attached. Such a document is known as a *reverse stock draft.*

(5) **Bill of Exchange.** These may be classified as to type into bank bills and trade bills, and as to tenor into long bills and short bills. A *bank bill* is a bill of exchange carrying the name of one or more recognised London banks or accepting houses. A *trade bill* is one drawn in connection with the sale of goods. The description may be even more precise, so that a "cotton" bill is one drawn against a sale of cotton. A *long bill* is one drawn payable at more than thirty days after date or sight, whilst a *short bill* is one drawn at less than this period, or which has not more than this time to run before maturity. When a bill is originally drawn against a shipment of goods, it usually has attached to it the documents of title to the goods, such as the invoice, the bills of lading, the insurance policy, and certificate of origin, so that the holder of the bill possesses a lien over the goods until he is assured all is in order. Bills with these documents attached to them are called *documentary bills*, whereas once

the documents have been detached, the bills are known as *clean bills*.

RATES OF EXCHANGE.—These are the rates published in the newspapers, and are the basis upon which remittances are made. The quotations mean that if a person wished immediate payment to be made he would hand over to a banker in London the required amount in sterling, and the banker would thereupon instruct his branch or correspondent abroad by telegram to pay the equivalent in currency at the rate indicated to a named person in that city as soon as the telegram had been received there and had been decoded. The rates at which these deals go through are called " cable rates " since the orders to the foreign agents for their execution are sent by cable. The table on pages 431–2 has been taken from *The Financial Times*. It shows the Official Rates fixed by the Bank of England, Market Rates, Forward Rates and Exchange Cross-Rates. It will be noticed that each place has two quotations, which are the buying and selling prices for the respective foreign currencies. The first part of each quotation is the price offered by the buyers and the other rate is the sellers' price; the one may be taken to indicate the demand for and the other the supply of exchange.

RELATIONS BETWEEN EXCHANGE RATES.—The *telegraphic transfer* rate is the foundation of all exchange dealing, but this rate is not applicable to the other forms of credit instrument enumerated above, and special rates have to be calculated in respect of them. In the first place, we have the "cheque" or "demand" rate, which may be defined as the rate applied to the purchase or sale of a bill payable at sight, such as a guaranteed mail transfer. As we have seen, in the case of such an instrument, allowance must be made for loss of interest. When a London bank buys such an instrument from a customer it pays out sterling immediately, but does not obtain the use of the foreign currency until a certain time has elapsed, so that it must compensate itself for the loss of interest by quoting a slightly less favourable rate to its customer. On the other hand, when selling, it receives sterling immediately, but does not have to provide the foreign currency until the cheque is presented. In this case the customer must be compensated for the loss of the use of his money by a slightly more favourable rate of exchange.

In addition to the quotation for cheques and sight drafts, further quotations have to be made in respect of bills of exchange drawn at a certain usance. Originally the term "long rate" denoted the rate

of exchange applied to such bills at a fixed usance, but it now relates to any bill having more than a few days to run. The term "*Tel Quel*" rate is also applied to an exchange rate calculated in respect of a bill of which part of the usance has already expired. In buying such bills, the dealer must make allowance for the following matters—

(1) Loss of interest on his outlay at the rate of discount ruling in the overseas centre upon which the bill is drawn.

(2) The cost of any foreign bill stamps, taxes, agent's collecting charges, etc.

(3) An allowance for his own profit.

FLUCTUATIONS OF EXCHANGE RATES.—The official rate of exchange between the currencies of two countries is not a rigid and permanent rate. As has been seen already, there are minor day-to-day variations applicable to different methods of settling international indebtedness. Also, a change in relative purchasing power of the currencies linked by a rate of exchange, or in the general pattern of trade between the two countries, will invalidate a rate and make it necessary for it to be changed to meet the new circumstances. Either the rate can be allowed to change to follow changes in the pattern of trade or of purchasing power, or positive controls can be exercised on the movements of trade and purchasing power in order to try to preserve the rate.

In very general terms, prior to the last war, the pattern of trade was allowed to affect the rate of exchange, with deliberate controls being brought in to prevent too violent fluctuations in that rate, while since the war deliberate exchange controls to fit the pattern of trade to the declared rates of exchange have been used.

An exchange rate is determined by the relationship existing at any time between the demand for and the supply of a particular currency. The factors of demand and supply in respect of the various forms of foreign exchange remittance, are themselves subject to a variety of influences, amongst which may be mentioned the following. The effect of these things is now limited by direct licensing of exports and imports and exchange controls on money movements out of or into the country—

(1) **Trade Conditions.** The necessity for making remittances in foreign currencies arises chiefly from international trade in goods and services. Although we may postulate, in normal times, that

FOREIGN EXCHANGES
17th December 1956

Dec. 15	Official rates	Market rate	
		Day's Spread	Close
New York (T.T.)	\$2.78–2.82	$2.78\frac{7}{16}$–$\frac{5}{8}$	$2.78\frac{1}{2}$–$\frac{5}{8}$
Montreal (T.T.)	—	$2.67\frac{1}{8}$–$\frac{1}{4}$	$2.67\frac{1}{8}$–$\frac{1}{4}$
Amsterdam	10.56–10.72 fl	$10.63\frac{3}{8}$–$64\frac{1}{8}$	$10.63\frac{3}{4}$–64
Brussels	138.95–41.05	139.95–05	$139.97\frac{1}{2}$–$02\frac{1}{2}$
Copenhagen	$19.19\frac{1}{2}$–$48\frac{1}{2}$ kr	$19.36\frac{7}{8}$–$37\frac{1}{2}$	19.37–$\frac{1}{8}$
Frankfort	$11.67\frac{3}{16}$–$84\frac{13}{16}$	$11.71\frac{3}{8}$–$\frac{7}{8}$	$11.71\frac{5}{8}$–$\frac{7}{8}$
Lisbon	79.90–81.10 es	80.00–10	80.00–10
Milan	$1{,}736\frac{5}{8}$–$62\frac{7}{8}$	1,754–$55\frac{1}{2}$	$1{,}754\frac{1}{2}$–$55\frac{1}{2}$
Oslo	19.85–20.15 kr	$19.92\frac{3}{4}$–$94\frac{1}{2}$	19.93–$\frac{1}{8}$
Paris	972.6–987.3 fr	$983\frac{1}{2}$–984	$983\frac{5}{8}$–$\frac{7}{8}$
Stockholm	$14.37\frac{5}{8}$–$59\frac{3}{8}$ kr	$14.45\frac{3}{8}$–46	$14.45\frac{5}{8}$–$\frac{7}{8}$
Zürich	$12.15\frac{3}{16}$–$33\frac{9}{16}$	$12.24\frac{1}{2}$–$25\frac{1}{4}$	$12.24\frac{3}{4}$–25
N.W.I.	—	5.26–5.29	5.26–5.29

OTHER MARKET RATES

Australia	125–$125\frac{1}{2}$	Ceylon	$1/5\frac{21}{32}$–$1/6\frac{3}{32}$
New Zealand	$100\frac{3}{8}$–101	Hong Kong	$1/2\frac{13}{16}$–$1/2\frac{15}{16}$
South Africa	$99\frac{7}{8}$–$100\frac{3}{8}$	Singapore	2/4–$2/4\frac{1}{8}$
India	$1/5\frac{15}{16}$–$1/6\frac{1}{16}$	Alexandria	$97\frac{1}{4}$–$97\frac{3}{4}$
Pakistan	$1/5\frac{15}{16}$–$1/6\frac{1}{16}$	Jordan	$99\frac{3}{4}$–$100\frac{1}{4}$

FORWARD RATES

—	One month	Three months
New York	$1\frac{1}{8}$–$\frac{15}{16}$ c. pm	$2\frac{15}{16}$–$2\frac{3}{4}$ c. pm
Montreal	$\frac{7}{16}$–$\frac{5}{16}$ c. pm	$1\frac{1}{4}$–1 c. pm
Amsterdam	$3\frac{1}{2}$–3 ct. pm	$8\frac{1}{4}$–$7\frac{3}{4}$ ct. pm
Brussels	$\frac{11}{16}$–$\frac{1}{2}$ fr. pm	$1\frac{3}{8}$–$1\frac{3}{16}$ fr. pm
Copenhagen	5–2 ore pm	13–10 ore pm
Frankfort	$4\frac{3}{4}$–$4\frac{1}{4}$ pf. pm	10–$9\frac{1}{2}$ pf. pm
Milan	3 lire pm-par	5–2 lire pm
Oslo	2 ore pm-par	3–1 ore pm
Paris	$\frac{3}{4}$–$1\frac{3}{4}$ fr. dis	3–5 fr. dis
Stockholm	3–1 ore pm	$5\frac{1}{2}$–$3\frac{1}{2}$ ore pm
Zürich	$4\frac{3}{4}$–$4\frac{1}{4}$ ct. pm	12–$11\frac{1}{2}$ ct. pm

EXCHANGE CROSS-RATES

Dec. 15	Stockh'lm	New York	Paris	Brussels	London	Amst'dam	Zürich
Stk'hlm	—	$5.17\frac{1}{8}$–$\frac{1}{2}$	1.468–470	10.3205–45	14.4595–4615	135.80–84	117.95–99
New York	19.32–34	—	*$0.28\frac{9}{16}$–$\frac{19}{32}$	*$1.99\frac{1}{2}$–$\frac{5}{8}$	*$2.78\frac{1}{8}$–$\frac{5}{8}$	*26.10–12	*$23.33\frac{1}{2}$–34
Paris .	6,808	350	—	702.7	984.2	9,250	8,032
Brussels	$9.68\frac{1}{2}$–69	$50.12\frac{1}{2}$–$14\frac{1}{2}$	14.23–$\frac{1}{2}$	—	140.05–07	$13.16\frac{1}{2}$–17	11.43–$\frac{1}{2}$
London.	$14.45\frac{5}{8}$–$\frac{7}{8}$	$2.78\frac{1}{2}$–$\frac{5}{8}$	$983\frac{5}{8}$–$\frac{7}{8}$	$139.97\frac{1}{2}$–$02\frac{1}{2}$	—	$10.63\frac{3}{4}$–64	$12.24\frac{3}{4}$–25
Ams'd'm	$73.55\frac{1}{2}$–$60\frac{1}{2}$	$3.82\frac{7}{8}$–$3\frac{1}{8}$	1.0807–17	$7.59\frac{3}{8}$–$\frac{7}{8}$	$10.63\frac{5}{8}$–$4\frac{1}{8}$	—	$86.82\frac{1}{2}$–$7\frac{1}{2}$
Zürich .	84.73–6	4.2850–52	1.2447–53	8.742–746	12.251–253	115.13–16	—

U.S. \$ on Montreal $0.95\frac{29}{32}$–$\frac{31}{32}$. Canadian \$ on New York $1.04\frac{1}{32}$–$\frac{3}{32}$. Milan on New York 624.94 Milan on London 1,749.832 *Free Rates. All others are official rates.

such transactions will occur in both directions, their aggregate values will never exactly balance, so that there will be a balance of indebtedness due from merchants in one country to those in another. This will create a demand for the currency of the creditor country and a sale of the currency of the debtor country, so that the value of the currency of the former will appreciate in terms of that of the latter.

(2) **Stock Exchange Operations.** Under this heading we may include investment and speculation in securities of international importance, as well as the raising of loans by one country in another. If England lends money to France or Englishmen buy securities on the Paris Stock Exchange, then French people acquire the right to withdraw funds from London, which tends to depress the value of the pound against that of the franc. If, on the other hand, the Argentine Government is paying interest on loans contracted in London, there will be a tendency for the value of the peso to fall in terms of sterling.

(3) **Banking Influences.** These include a variety of operations which have had, in recent years, a very considerable influence on exchange rates. Since 1918, the majority of banks with international connections have kept a large proportion of their balances in a liquid form in different financial centres, and have moved them from one centre to another as appeared profitable. Such movements of short-term funds, indeed, played a considerable part in our abandonment of the gold standard in 1931. Under this heading, too, we must recognise the influence of arbitrage operations; that is, the buying and selling of foreign currencies by the banks with the object of making profits out of the differences existing between various exchange rates.

(4) Currency Conditions. Since the foreign exchange market is concerned with the valuation of one currency in terms of another, any alteration of a currency system within a country tends to have reactions upon the foreign exchanges. Thus, inflationary action by way of an expansion of the note issue or an over-extension of credit has an immediate effect upon foreign exchange rates. Frequently these influences exercise a disproportionate effect upon the exchanges on account of the psychological factor. The mere fact that a currency has depreciated leads people to anticipate still further depreciation, which is reflected in the exchange rate.

(5) Political Conditions. The trend of domestic politics, and particularly the budgetary position, are important factors in influencing exchange rates. An unbalanced budget has often been the prelude to currency inflation and financial instability, so that the holders of short-term capital are led to try to increase their security by moving their funds to another centre. Again, the possible accession to power of a body of political thought antagonistic to capital is likely to cause a similar movement. The current industrial position, as revealed by indices of production and employment, exerts a similar influence.

ELIMINATION OF EXCHANGE RISKS.—These fluctuations in exchange rates could be a considerable source of uncertainty to traders, since, in the absence of special protection, debtors could never be certain as to their expenses in obtaining the foreign currency necessary to settle their indebtedness. Suppose an English merchant bought from France, on three months credit, goods valued at 1,000,000 francs, when the franc was 1,000 to £1. At that time, he knew that the cost of the goods in sterling was £1,000, and he would fix his selling price on this basis. If, however, when he came to settle the debt the exchange rate had moved so that it was 950 francs to £1, then he would have to find £1,052 12s. 8d. This would probably cause him to make a loss on the transaction. Under a gold standard, these fluctuations are narrowly limited, but in the case of inconvertible paper currencies they may be of considerable magnitude. In order to avoid the uncertainty and possible loss arising from these variations, the following devices may be used—

(1) Exchange Clauses. These are recognised forms of wording included in sterling bills drawn by creditors in this country in order to ensure that they receive the full amount of sterling, and that any

exchange risk is thrown on the foreign drawee. An exchange clause is included in the wording of such bills and fixes the method of arriving at the rate of exchange at which the drawee must settle the bill. The difficulty is, of course, to get the drawee of such a bill to accept such a clause. As an example let us consider the case of one of the best-known of these clauses, namely, "*Exchange as per endorsement.*" A merchant who has drawn a bill in sterling, bearing this clause, will sell it to his bank at the full face value. The bank, on taking the bill, will immediately calculate a *tel quel* rate of exchange so as to reimburse itself not only for the amount of the bill, but also all expenses and its margin of profit. This rate will be included in the endorsement of the bill, and the foreign debtor will have to settle at this rate.

(2) **Forward Exchange.** The most common method of guarding against exchange fluctuations is by the use of the facility known as forward exchange. Under this system, a banker will give a merchant a definite quotation in the present for the purchase or sale of a foreign currency at some date in the future. Forward contracts can be arranged for a fixed date or for an "option date," when the actual day of delivery is uncertain. In these circumstances the "option" relates to the *time of completion* of the contract, and the currency must be bought or sold by the last date of the option. The normal maximum period for foreign exchange contracts is three months, and although transactions can sometimes be arranged in the major currencies for longer periods, traders cannot rely on this.

(3) **Foreign Currency Accounts.** A firm having numerous dealings in a foreign country may maintain its own current account in local currency with a foreign bank. In these circumstances, all receipts are credited to that account and all local payments are charged against it. Where this arrangement is undertaken there can be no loss in exchange except when the balance is converted to sterling.

EXCHANGE RESTRICTIONS AND CONTROL.—The traditional method of regulating the exchange value of a currency on the gold standard was through the bank rate policy of the central bank. When a country's external payments exceeded its receipts, the exchanges moved against it to the gold export point, i.e. to the point at which it would be cheaper to ship gold out to the creditor nation to settle the adverse balance of payments. There was an outflow of gold, leading to a constriction of credit, a rise in interest rates, and a

fall in internal prices. If the initial mischief was not too deep-seated this chain of events provided an automatic cure, for rising interest rates attracted fresh funds from abroad, while the fall in prices stimulated exports and checked imports. Thus the exchange rate tended to return to normal.

When a currency is free or inconvertible these checks do not operate, and it must either be left to fluctuate in accordance with the position of the balance of payments or the whims of speculators, or it must be controlled by official action. This control may be exerted through exchange restrictions, which are official measures having as their object the limitation of the freedom of foreign exchange transactions. An example of this is furnished by the system of the nominal maintenance of the gold standard coupled with the restriction and regulation of the exchanges. Under this system, the central bank is still nominally free to sell and export gold, and the exchanges are still officially quoted at par. The Government, however, obtains legislative powers enabling it to prohibit remittance abroad of funds for certain specific purposes. Again, there may be prohibitions upon the discharge of outstanding indebtedness to foreign creditors. In such circumstances, the money due to the foreign creditor is said to be "blocked" inside the country, and even its employment within the country is often limited.

Instead of mere restriction, we may have Government intervention in the foreign exchange market, and operations are undertaken by the authorities with a view to influencing the exchange rates. This intervention may be either passive or active. In the former case, we have the method of "pegging" the exchanges at a given rate, at which the bank or banks in charge of the operations are prepared to buy or sell any amount of foreign currencies. Thus, the dollar-sterling exchange was pegged by the Government from 1916 to 1919 at the rate of \$4.76½ per £. Active intervention, on the other hand, means that the authorities or their agents take the initiative in operating in the market, thereby seeking to influence the exchange rates. This form of intervention, if efficiently carried out, is one of the least objectionable, since it imposes no hindrance on either trade or financial activities.

This last method of exchange control was the one which was resorted to by the British Government in the *Exchange Equalisation Account*. This account was created by the Finance Act of 1932 by

the issue of £150,000,000 of Treasury Bills, together with £25,000,000 which formed the residue of the old Exchange Account of pre-1914 origin. In 1933, it was decided to raise the amount of the fund to £375,000,000. Those operating the account were entitled to hold its assets in the form of gold, sterling, or foreign exchange, and to exchange from one into the other at will. According to the text of the Finance Act, the object of the fund was "the checking of undue fluctuations in the exchange value of sterling." There was no thought of preventing any normal fluctuations of sterling.

In 1936 and 1937 the difficulties of the French franc caused the migration of a large volume of French short-term funds to London. In an attempt to prevent this movement from influencing unduly the internal credit position of Great Britain, the Account was obliged to hold a large portion of its resources in the form of gold. In order to provide additional funds to conduct its operations the Account was increased to £575 million in June, 1937. On the outbreak of war in 1939 practically all the gold held by the Bank of England was transferred to the Exchange Equalisation Account, rates of exchange were rigidly fixed, and the normal activities of the foreign exchange market came to an end. The Government took steps to control all financial assets so as to provide the greatest support for the war effort. The Defence (Finance) Regulations issued under the Emergency Powers (Defence) Act, 1939, controlled the transfer of certain classes of securities and made it possible for the Treasury to acquire such securities if it so desired. The purchase and sale of foreign currencies and gold were only permitted with the approval of the authorities. All such transactions were canalised through the Bank of England and twenty-five banks which were recognised by the Treasury as authorised dealers in all currencies. Certain Dominion and foreign banks were authorised to deal in particular currencies. These regulations did not apply to the "sterling area," which then consisted of the British Commonwealth (except Canada and Newfoundland), Egypt, Anglo-Egyptian Sudan, and Iraq.

A further control in 1940 was the introduction of "registered" and "special" accounts as a result of bilateral agreements between Great Britain and certain governments. This was designed to prevent the transfer of sterling from the accounts of one country to those of another.

One of the conditions of the Anglo-American Loan Agreement of 1945 was that restrictions on current transactions would be removed and sterling would become available for current transactions in all areas. This was to come into effect in July, 1947. Steps were taken by the British Government to increase the convertibility of sterling and thereby fulfil the agreement. The introduction of "transferable accounts" in February, 1947, went a long way to increase the convertibility of sterling, but unfortunately it resulted in greatly reducing Britain's dollar resources and in August, 1947, convertibility had to be temporarily suspended. The various control arrangements which developed during and after the war have been embodied in the Exchange Control Act, 1947.

While many relaxations and modifications have taken place since that date, exchange rates are still held steady by import–export restrictions and exchange controls, but at the same time the big disparities in trade have largely closed and so much modified the influences tending to invalidate the rates.

TEST PAPER

1. What is meant by the Foreign Exchange?
2. Can you suggest any explanation for the fact that the Bills drawn on London considerably outnumber those drawn by Great Britain on places abroad?
3. State fully what you consider to be the advantages to be secured by the use of bills in connection with commercial transactions—
   (*a*) When the debtors are resident in this country;
   (*b*) When the debtors are resident abroad.
4. Specify the chief causes of fluctuations in the Foreign Exchanges.
5. What are the principal factors which may cause instability of the foreign exchanges? What measures have been taken by the British Government to minimise this instability since 1931?
6. Distinguish between spot rates, demand rates, and *tel quel* rates of exchange. What do you understand by "forward exchange"?
7. Show how the exchange between London and New York would be affected by (*a*) a failure of the wheat harvest in England, (*b*) a financial panic in the United States, (*c*) a diminution in the tourist traffic between America and Europe, and (*d*) the repayment of a large amount of England's War Debt to America.
8. Describe the objects and the mode of operation of the British Exchange Equalisation Fund.
9. Give (*a*) the method of quoting, (*b*) the par of exchange, and (*c*) the approximate present exchange rate, in relation to the currencies of the following cities: New York, Paris, Amsterdam.

CHAPTER XLIV

The Money and Capital Markets

FINANCIAL ORGANISATION.—As the economic system develops in complexity, it becomes increasingly dependent upon its banking and financial organisation. So long as production is carried on for a purely local market the problem of effecting the settlement of trading transactions is comparatively easy of solution. As the distance between the parties increases with the development of international trade, the need for a special organisation to cope with the problems of financial settlement becomes evident. At the same time, too, greater complexity of economic organisation establishes a demand for capital in large quantities, and institutions come into being for the purpose of satisfying this demand. Financial organisation in its modern form, however, developed with the use of credit instruments such as bills of exchange, shares, and bonds. By the use of these devices, the *liquid resources* of a large number of individuals could be concentrated in the hands of a few institutions which, although not the owners, had the power of the free disposal over them. In this way financial institutions have attained a position of first-class importance in modern economic life, with the result that many people now consider that they should be brought under the direct control of the State.

The *functions* which the financial organisation has to discharge has given rise to varying degrees of specialisation in different centres. Consequently, in most developed centres, the following divisions may be recognised—

(1) **The Money Market** which is engaged in short-term financial operations. It includes transactions in what is known as the Call Loan Market, in which funds available only for very short periods are lent out. So far as London is concerned, this section is primarily associated with the market in bills of exchange, that is the discount market. Secondly, it comprises the operations broadly described as commercial banking, which is concerned primarily with the receipt of deposits and with the granting of short-term loans to finance goods in process of manufacture and in the various stages of distribution.

(2) **The Capital Market** is the organisation through which the supply of, and the demand for, new long-period capital is adjusted. The funds which it supplies may take the form of long-term capital for investment in fixed assets or to serve as permanent working capital for a business; alternatively, it may take the form of long-term loans to central and local government authorities. The institutions engaged in this market comprise issuing houses, investment trusts, and finance companies, whilst the commercial banks participate, though to a limited extent.

(3) **The Stock Exchange,** which may be described as a market for transferring the ownership rights in already existing securities. It is an indispensable adjunct to the long-term capital market described above. It provides facilities whereby investors can liquidate their holdings of capital and thereby induces a greater readiness to invest. At the same time the stock exchange organisation facilitates new investment by providing safeguards for the investor by its investigation of new security issues before granting permission to deal in them on the exchange.

(4) **The Central Bank,** which is the principal financial institution of the whole system and controls its activities in the interests of general financial stability. The general characteristics of such an institution, of which the Bank of England is a particular example, have already been discussed, and it operates under varying degrees of Government control. The necessity for a central bank is urgent at the present day, since one of its fundamental duties is that of the control of money and credit. The control of credit is particularly important under existing conditions, since the greater part of financial activity is based upon the use of credit.

Each great financial centre has its own characteristics, which reflect the economic background against which it has developed. Thus, the City of London has hitherto been noted for the facilities given by the *short-term* money market for the employment of home or foreign funds; in the financing of trade and commerce, both home and foreign; and in the issue of foreign bonds, as distinguished from the financing of British industry. In the past, the market has been singularly free from official interference—a fact which has served to mark it out from foreign centres and has contributed in no small measure to its development.

THE MONEY MARKET.—This section of the financial organisation

is concerned with dealings in *short-term capital*, and is therefore of considerable importance in the day-to-day finance of business operations. Thus it will be concerned with the provision of working capital for manufacturing enterprises, the finance of commodities in the course of distribution between producer and consumer, and the dealings in the credit instruments which arise from these transactions. It forms a meeting place for those institutions which have short-term funds seeking temporary investment, and those which can put such funds to profitable use and at the same time preserve the requisite degree of liquidity to enable repayment to be made at short notice. The London Money Market has long been recognised as the most comprehensive and highly organised of the world's financial markets. One of the principal reasons for its supremacy lies in the concentration of British banks upon "deposit" as opposed to "industrial" banking. In consequence, London always possesses, from internal sources alone, an abundant supply of floating balances perpetually seeking short-term investment.

The great commercial banks are thus the most important constituents of the market, since they supply the bulk of the commodity in which it deals. Colonial and foreign banks and finance houses also find it profitable to deal in the London money market, and there is usually a large amount of foreign capital from these sources seeking investment. Again, the market may be supplied with funds awaiting permanent investment in the hands of financial institutions, such as the proceeds of loans and sums available in anticipation of dividend requirements. The regular borrowers are the discount houses, and the stock market operators who need funds to enable them to "carry" the bills of exchange or the stocks in which they are dealing. Again, the acceptance houses may occasionally borrow, though they are often lenders. Finally, the Government itself is a large borrower in the market by the sale of *Treasury Bills.*

The following may therefore be said to be the principal institutions of the money market—

(1) **The Commercial Banks.** Under the English system of deposit banking, the capital resources of the joint stock banks are supplied mainly by their depositors. These deposits are to a very considerable extent repayable on demand, and even those deposits which are fixed for a period may be payable on demand by arrangement with the depositor. In consequence, a considerable sum has to be

held in the form of actual cash which earns no revenue for the bank. Over and above this, however, a large proportion of the assets must be kept very liquid, so that if there are withdrawals of cash owing to a shrinkage of deposits, cash reserves may be replenished quickly. The London money market, with its resources for the employment of short-term funds, offers a channel in which this capital may find profitable employment and at the same time be readily available in case of need. The commercial banks cannot afford to hold a balance of idle cash over and above their standard ratio of 8 per cent, since they have to allow interest on much of their deposits and cover their heavy working expenses. They, therefore, lend any surplus cash to the money market for varying periods. Money is lent out fortnightly, weekly, or monthly, according to the position of the bank, whilst money is lent for a few days to the stockbrokers for the fortnightly account. The banker will have at his disposal daily a large sum of money which he can either reinvest in the market or which he can utilise to meet any demands which are made upon him by depositors. Actually, in normal times, the great bulk of these funds are simply reinvested so that they remain at the disposal of the market for an indefinite period. Another class of loan is known as the *over-night loan*, which comprises temporary advances to bill-brokers to enable them to take up bills of exchange offered towards the close of the day's business. These loans are automatically repaid on the following morning.

Prior to 1947, the amount available in the market from day to day varied on account of the practice followed by the principal banks when compiling their weekly accounts. The eleven London Clearing Banks publish monthly figures of reserves in cash and at the Bank of England. These figures were the averages of one selected day in each week of the month, and on that day it was the practice of each Clearing Bank to call in a proportion of its loans to the market, returning them the next morning. Again, since by arrangement the clearing bankers spread their making-up over four days of the week, there were only two days when the full amount of loanable credit was actually available. The Macmillan Committee, commenting upon this practice, likened part of these cash reserves to a stage army, since the same liquid resources did duty four times over in the course of each week. This practice, known as "window-dressing," has now been stopped. The Clearing Banks publish a

statement of their balances on the third Thursday of each month.

(2) **Acceptance Houses.** These form part of the specialised machinery of the London money market for dealings in bills of exchange. These institutions, in their capacity as acceptance houses, do not make actual advances of money. They only lend their names to their customers in return for a commission, so that the latter may more readily obtain credit on a bill of exchange. Suppose that a merchant in Brazil is going to sell coffee to a dealer in London. The dealer approaches an acceptance house to open a credit for him in respect of the transaction. Upon receiving their consent, the London dealer instructs the Brazilian merchant to draw a bill on the acceptance house for the value of the consignment. In all probability the foreign exporter will sell this bill, with all the shipping documents attached, to a local bank, and the latter transmit it to London, where it is accepted by the acceptance house. The latter will retain the shipping documents and may hand them over to the London dealer against payment of cash, or against his undertaking to place funds at their disposal against the time when the bill falls due for payment. Under this system, therefore, the credit of the acceptance house is interposed between the seller and the buyer, and assists in the development of trade by promoting confidence. Banks and other financial houses would naturally hesitate to deal in a bill of exchange drawn on an unknown foreign importer, whereas they would take without question a bill drawn under authority upon a London acceptance house. For this service the acceptance house charges a commission which varies according to the credit standing of the person who asks for it.

Practically every acceptance house of old standing in this country commenced as a merchant house trading with foreign countries. It was largely through the offices of these merchants that London became the market and distributing centre for such a large number of raw materials and other commodities. Through these merchants the sterling bill became the international currency of the world, and as a result a considerable part of the shipments of goods between one part of the world and another is financed by bills drawn on acceptance houses and banks in London. This type of business requires considerable experience coupled with a very careful study of world conditions. Since the acceptance houses are specialist, they can transact business which under ordinary conditions might appear

risky, but they are justified in taking that risk because of their special knowledge. For the more efficient conduct of their operations the principal acceptance houses have correspondents and affiliations throughout the world. Thus the London house of Lazard & Co., Ltd., has affiliations with Lazard Frères of Paris, which is a French house, and with Lazard Frères of New York. The London house has also founded a connection in Spain and has a branch in Antwerp and in Brussels. In addition to these, the business has hundreds of correspondents in different parts of the world.

While the mere acceptance of a bill does not involve the immediate financing of trade in cash, bills always tend to be discounted in the market in which they are accepted. This has given rise to a criticism that the market is favouring foreign exporters at the expense of British exporters in providing them with cheap acceptance credit facilities. Yet the existence of this business has brought foreign deposits to this country, which are invested in the money market, and these funds may be said to finance the business. Again, in addition to the substantial commissions which London normally earns from the acceptance business, it also brings all kinds of other business owing to the enormous number of connections which are established. It must be remembered, moreover, that these facilities are equally available for British business houses of good standing, though they are not employed as widely as they might be on account of the aversion of many British firms from the use of bills. At the same time the facilities of the market may be abused as when acceptance credits arranged under the guarantee of foreign banks are used for drawing finance bills under the disguise of commercial bills.

(3) **Discount Houses.** These are institutions which purchase bills before maturity for a sum less than their face value, making their profit on the margin. The *discount market* of London consists of nine public companies and three private limited companies, whose annual turnover of bills amounts to a very large total. As already indicated, the discount market is largely dependent for its resources upon the volume of the funds which the joint stock banks can place at its disposal. By lending funds in this way to the discount market, instead of investing the whole of them in bills directly, the commercial banks gain a number of advantages. They receive a greater degree of security than is the case when they buy direct, because the bills have passed under the searching scrutiny of a specialist in that

type of investment. Further, the bills are backed by the credit of the discount houses pledging them as security for the loan, whilst at the same time the lending banker is not concerned with variations in the capital value of the bills. Again, in the London money market, the discount market provides the link between the central bank and the commercial banks. It is the channel through which any additional bank cash required by the banking community is obtained from the Bank of England. Should the commercial banks require to strengthen their cash position, as, for example, when making up their half-yearly accounts, they call in part of their loans to the discount market. The discount houses, however, have these funds invested in bills of exchange and, in order to meet the demands made upon them, are compelled to borrow from the Bank of England on the security of bills of exchange. Since the Bank will only take bills of an approved type, bearing at least two good British names, one of which must be the acceptor, the discount houses have to exercise due discretion in buying bills.

After the 1931 crisis, the difficulties of the discount market increased considerably. The inland bill of exchange found practically no place in the internal trade of this country, since traders preferred to finance their businesses by bank loans or overdrafts rather than by the discount of bills of exchange. Further, the shrinkage of international trade naturally reacted upon the supply of commercial bills and curtailed the volume of paper coming forward for discount. But the composition of the market, even prior to the depression, was gradually changing on account of the growth in importance of the Treasury Bill. To-day the discounting of Treasury Bills is the main function of the discount houses. Every Friday the Government informs the Money Market of the number of bills it is prepared to issue and invites tenders from the discount houses. In the first quarter of 1960 between £250 and £290 million of Treasury Bills were issued weekly at a discount rate of about 4½ per cent.

The discount market is an essential part of our financial machine and its loss would entail a serious diminution in the financial prestige of London. Furthermore, if its effectiveness were to be impaired, the Government itself would be likely to experience difficulties in its short-term financial operations, whilst the commercial banks would probably be driven to invest their short-term

funds in the stock market—a line of procedure which experience in other centres has shown to be undesirable.

(4) **Bill Brokers.** In addition to the large discount houses, there are several other firms specialising in the discounting of bills, both as principals and as agents. The bill broker may be considered as an agent whose function it is to bring buyer and seller together and not to deal on his own account. This type of dealer is known as a *running broker*, since he goes from bank to bank, finding out the kinds of bills that certain banks wish to buy and the kind that others wish to sell. Thus, the Eastern and foreign banks always have quantities of bills for sale, which they have received from their foreign offices and customers. On the other hand, the commercial banks are constantly on the look out for bills of special types and maturities. A banker always seeks to hold such a portfolio that some bills are maturing every day, so that he will be continually wanting bills of some particular date to fill a gap. The running broker unites these sources of supply of and demand for bills. He is, as a rule, a man of small capital, so that he is unable to carry the bills he buys, but must immediately sell them at a fractional profit—usually $\frac{1}{32}$ or $\frac{1}{64}$ per cent per annum.

The larger firms acting as principals as well as agents are of a somewhat higher financial standing. They may be regarded in the light of retail dealers in bills who buy them outright either from the running broker or from merchants, and sell them again to the bankers and other buyers. They have a relatively small capital of their own, and the bulk of their purchases are financed by loans from the banks, secured by their stocks of bills. These brokers do not usually make themselves parties by endorsement to the bills they purchase, but they usually give a letter of guarantee to the buying bank, undertaking to take up any bills which may be dishonoured.

(5) **Bullion Market.** The fact that practically 75 per cent of the world's gold productions comes from within the British Empire has had a material influence in making the London Bullion Market the most important in the world. The business of the market is conducted by four firms of bullion brokers, whilst, in addition, two other firms operate refining plants. The abandonment of the gold standard by this country in 1931 did not materially affect the market, since business was not subject to official regulation, and the free

import and export of gold was unrestricted. When this country was on a gold standard, however, the market quotation for gold was naturally limited to within a fraction of the Bank of England's buying and selling prices. Before the war, however, the price of gold was mainly governed by the rate of exchange ruling between this country and those which still remained on gold.

(6) **Foreign Exchange Market.** In every important financial centre there exists a more or less organised foreign exchange market in which foreign currencies are bought and sold. In this section of her financial activities, London's relative importance has increased considerably during the past fifty years, especially since the War of 1914–18. This has been largely due to the fact that, whereas before 1914 British traders mainly bought and sold on a sterling basis, much more business is now transacted in other currencies. Since the final abolition of the meetings in the Royal Exchange at the end of 1920, the London market has no central meeting place. Indeed, the market is nothing more than a close network of telephones connecting up dealers and brokers, and spreading out farther by telephone to the provinces and to the nearer Continental centres, and by cable to more distant markets. The actual dealers in the market are the banks and financial houses who maintain foreign exchange departments, numbering over one hundred. No direct business is done among the dealers themselves, but every operation is carried out through the mediation of a broker.

The market is under the joint control of the London Foreign Exchange Bankers' Committee and of a Committee of the London Foreign Exchange Brokers' Association. These bodies, which were originally created after the First World War, were reconstituted in 1931 at the request of the Bank of England in order to regularise the operations of the market.

On the outbreak of the Second World War, the Government took control of the foreign exchange market and much of the business of the merchant banks and foreign exchange brokers came to an end. Exchange transactions were only permitted to take place through the authorised banks, and then only with the approval of the authorities. When the war came to an end, the Government was faced with great financial difficulties, which made it necessary to continue with the wartime system of exchange controls. The various regulations were embodied in permanent statutory form

in the Exchange Control Act of 1947. Although many of these regulations have been relaxed, the essential controls still remain.

THE CAPITAL MARKET.—Under this heading we have to consider that section of the financial organisation which is concerned with the supply of permanent or of *long-term* capital for the use of business enterprise. As already indicated, this market cannot be clearly separated from the short-term capital market discussed above, since in some cases financial institutions operate in both sections. Thus, in the case of the commercial banks, although the nature of their obligations is such that they must keep their assets as liquid as possible, yet it is well known that they have given considerable assistance to industry by extending long-term capital facilities. Again, the Stock Exchange exists to facilitate the transfer of long-term capital securities, yet much of its business is financed by short-term money market loans. The market, therefore, is by no means clear-cut and definite, and the institutions connected to it shade off into other lines of business. It is composed of a nucleus of institutions engaged principally in raising long-term capital, including issuing houses, trust and finance companies, company promoters, and underwriters. About these we find a much less centralised and organised group, including building societies, insurance companies, solicitors, and others. Moreover, with the exceptions considered below, the English market tends to offer more generous facilities to the large concern of the joint stock company type than to the small business.

The following are the principal institutions of the market—

(1) **Issuing Houses.** The function of the issuing house has been defined by Lavington in *The English Capital Market* as being "to formulate the demand for capital, to present this to the public by the offer of securities, and to facilitate the flow of capital from the public in response." This work applies not only to capital issues for the purposes of domestic industry and commerce, but also to issues for the benefit of foreign borrowers. In many cases, the *issuing house* purchases the securities which are being issued and re-sells them to the public, thereby assuming a certain amount of risk. This involves a certain warranty of the solidarity of the security and operates as an implied guarantee to the investing public that the proposition has been thoroughly examined and the interests of the investors protected as far as possible. Thus, in the

case of an industrial issue, the issuing house has to make an entirely independent examination of the company's position. It should make a study of the industry and the markets in which the company trades; it must use its judgment as to the possibilities of continued prosperity of the concerns along the lines of commercial policy laid down by the management, which includes a study of the uses to which the new capital is to be put. When all these factors have been considered and the scheme has been thoroughly tested, the issuing house can then prepare to make the actual issue. It has on its staff skilled officials whose duty is to study the public taste and to present to potential purchasers the facts of an issue in the most attractive form.

It was pointed out by the Macmillan Committee that, so far as the London capital market is concerned, a higher degree of organisation is provided in respect of foreign loans than in the case of domestic capital issues. The report emphasised the fact that industry was becoming increasingly internationalised, and that although foreign industrial concerns obtained considerable support from wealthy banking and financial groups, our own industries were at a marked disadvantage in this respect.

(2) **Company Promoters.** The work of the company promoter is somewhat indefinite in character. He may be regarded as a financial intermediary standing between the investor and the business organiser who needs capital for the finance of new inventions, new processes, or reorganisations of industrial structure. When a new company is being formed for the purchase of an existing business or other property, the vendor may assume the functions of the promoter. Again, the work of promotion may be performed by a registered company which is engaged in the formation of a subsidiary or allied business enterprise. Finally, he may be an independent financier who is concerned solely with the profit which he can make by bringing about a successful flotation. In this latter case, in particular, since the promoter has no intention of associating himself permanently with the interests of the new company, his desire to maximise his profit may lead him to over-capitalise the concern. The law attempts to check abuses of the system by insisting upon a full disclosure of all relevant details, and by imposing penalties for false and misleading statements. At the same time, however, it must be recognised that the law cannot afford complete

protection to investors unless they are prepared to exercise a certain amount of discrimination for themselves. At its best, the system of company promotion can be of great assistance in facilitating the flow of capital into industry, but it is notoriously liable to abuse.

(3) **Underwriters.** The underwriter in the floating of a share issue guarantees to the promoter that a minimum amount of the capital which he is desirous of placing will be subscribed. Under Section 47 (1) of the Companies Act, 1948, in the case of a first allotment of shares, no public company can proceed to allot any of its shares offered to the public for subscription until a minimum amount of the share capital, known as the "minimum subscription," has been subscribed. Moreover, the Fourth Schedule of the Act states exactly what the directors must take into account in fixing this minimum subscription. An issue of shares entails considerable expense, and, if the issue fails, the burden of this falls upon the promoters. Hence, in order to protect themselves, the promoters or the issuing house take out a kind of insurance in the form of underwriting contracts. An underwriting contract has been defined as "an agreement entered into before the shares are brought before the public, that in the event of the public not taking up the whole of them, or the number mentioned in the agreement, the underwriter will, for an agreed commission, take an allotment of such part of the shares as the public has not applied for." The practice of underwriting was introduced in the 'nineties of last century, but it merely superseded and widened the system by which, when an issue was being made, a syndicate was formed with which a sufficient amount was provisionally placed to secure success.

In the case of a large issue, the risk will be too great to be carried by one firm, so that contracts may be made with a number of underwriters. Alternatively, one firm may underwrite the whole issue and then, in order to protect itself, arrange sub-underwriting contracts. In these circumstances, the underwriting commission is passed on to the sub-underwriters, and the principal underwriters retain what is known as an *over-riding commission* for their services.

(4) **Investment Trusts.** These are companies which raise capital and invest it in securities in such a way as to give the best possible income with the minimum of risk. In Great Britain the first trusts were formed in Scotland by groups of individuals—usually co-heirs

of large fortunes—who handed over the administration of their funds to a trustee. Resulting from these successful associations, the first investment trust company was formed in London in 1863, and by 1890 the movement had become popular in both countries. The modern investment trust permits the application of specialised knowledge and skill to the business of investment. This results in the obtaining of a larger yield, combined with greater security of capital and income, than is usually possible to the individual investor, through the principle of diversification. Thus, throughout the depression of 1929–34, the movement as a whole continued to earn profits. An important feature of these undertakings in this country is the low cost of administration which distinguishes the leading trusts. It is stated that this seldom exceeds $\frac{5}{8}$ per cent of the company's capital. In the ordinary investment trust, the securities may be changed from time to time under skilled direction. Another type, however, less common in Great Britain, known as the *Fixed Trust* simply holds certain specified shares, but does not change them. The group of securities selected constitutes a unit divided into a given number of sub-units. The purchaser of a given number of sub-units knows that he is acquiring a proportionate share in the block of securities. The selected shares are deposited with trustees who receive all payments by way of dividends, and forward to each holder of sub-units his proper proportion of such payments each half-year.

(5) **Finance Companies.** Certain of these concerns perform work which is similar to that of the investment trusts, except that they tend to specialise in a group of concerns in one industry, and aim at controlling the enterprises in which they are interested. The investment banking houses found in the United States may be classified under this heading. In Germany, again, many of the banks were compelled to associate themselves closely with industrial development. On account of the scarcity of capital and the lack of investors in the early days of industrial development, the banks were driven to assist industry to obtain permanent as well as short-term capital. When they accepted this responsibility, they were obliged to keep in more intimate touch with the industries with which they had allied themselves. The practical means to this end is the association of the bank with the boards of industrial and trading enterprises. Thus, the managing directors of the banks

are generally on the boards of the most important concerns; the managers are often delegated to the boards of smaller companies, whilst branch managers are nearly always to be found on the boards of the local concerns in their districts. This relationship commences upon the foundation of the business. Whether it is a case of converting a private firm into a limited company, or of exploiting a new invention by establishing a new enterprise, the assistance of a bank is always invoked. The bank examines the situation and, when necessary, obtains reports from experts. If the bank, after examination, decides to proceed with the scheme, it draws up the plan of financing, determines the amount and the type of capital to be issued, and then, in some cases, itself takes a part of the shares into its security portfolio with the idea of issuing them at a later date.

Such institutions as these, for the purpose of providing *long-term* finance for industry, are almost unknown in this country. Complaints have frequently been made to the effect that many manufacturers desiring to extend their works, and possessors of sound businesses, can make no successful appeal to the ordinary investor, and find themselves cramped through their inability to borrow even relatively small amounts for long periods. This position is largely due to the fact that before 1914 manufacturers provided new capital for themselves out of their reserves. This was the more easy to do, since many of them operated private family businesses, and therefore it was much more easy to put big profits into reserve than it is where there are a number of shareholders wanting a dividend. Since the 1914–18 War this course of action has in many cases been impossible, and new organisations are needed to cope with the problem. The Macmillan Committee, after commenting on this deficiency in British financial machinery, visualised the foundation of institutions performing the following functions—

(*a*) Acting as financial advisers to existing industrial companies.

(*b*) Advising in particular as to the provision of permanent capital, its amounts and types.

(*c*) Securing the underwriting of and issuing the company's securities to the public, and, if necessary, assisting previously in arranging for the provision of temporary finance in anticipation of an issue.

(*d*) Assisting in financing long contracts at home and abroad, or new developments of an existing company, or founding companies for entirely new enterprises.

(*e*) Acting as intermediaries and financial advisers in the case of mergers or in the case of negotiations with corresponding international groups.

BUSINESS FINANCE.—Business finance may be defined as the means adopted by business enterprises for raising and administering the funds required to enable them to conduct their operations. At every stage in the life history of the business unit those who are responsible for its direction and management are concerned with questions of finance. From the time when the undertaking comes into existence as a legal entity, and often long before, to the time when it passes out of existence, finance tends to be the dominant consideration in each of its activities. Business finance, therefore, is concerned with such questions as the following—

(1) The conditions under which a new enterprise may be launched.

(2) The basis of its capitalisation and the manner in which funds are raised.

(3) Determination as to when expansion may take place.

(4) The financing of purchases.

(5) The financing of production and the control of production costs.

(6) Determination of the financial aspect of the sales policy in such matters as terms of sale, collections, discounts, and credit.

(7) The exercise of financial control over every department of the business.

From the foregoing it will be seen that the subject of business finance is co-extensive with the activities of the business itself.

RECENT DEVELOPMENTS IN INDUSTRIAL FINANCE.—The prolonged depression in the basic industries of this country revealed the need for a drastic reorganisation of their technical and commercial structure. Yet the depression and a long-continued reduction in demand had caused a widespread failure to earn profits and inability to build up reserves or even to make sufficient provision for depreciation. As the Balfour Committee pointed out in 1929, financial weakness always tends to constitute a vicious circle, since an undertaking or industry whose earnings are insufficient to provide for depreciation and reserves finds great difficulty in keeping its

equipment up to date. The more antiquated and inefficient becomes its equipment, the greater becomes the financial weakness and the smaller becomes the possibility of obtaining the fresh supplies of capital which may be the only means of restoring profit-earning power. There was an urgent need for co-operation between bankers and industrialists in order to assist industrial reorganisation. In order to give a lead in this work the following institutions were created—

(1) **The Securities Management Trust.** This is a private company formed under the auspices of the Bank of England, which holds the whole of the capital. Owing to abnormal circumstances the Bank acquired certain securities, the possession of which brought it into contact with industry which is no part of a central bank's normal duty. This concern was therefore established to take over this business and conduct it in another building as a matter quite distinct from the Bank's ordinary functions. It must be regarded as a temporary industrial adjunct of the Bank. Its main objects are to advise industry and to examine schemes for reorganisation, to provide in some cases initial capital, or to ensure that schemes are of such a nature as to justify appeals for financial assistance in other quarters. In order to carry through this work, the Trust obtained the full-time services of various experts, technical, accountancy, legal, and labour. The functions of the Trust are mainly consultative and advisory, and it is not intended to form the nucleus of a national credit bank, nor is it an attempt on the part of the Bank of England to enter the field of industrial finance.

(2) **The Industrial and Commercial Finance Corporation.** This company was formed in 1945 by the Bank of England and other British banks for the purpose of financing the small business. It is also prepared to offer financial assistance in starting a business. It has a capital of £15 millions and additional borrowing powers of £30 millions. The capital is subscribed by the clearing banks, the Scottish banks and the Bank of England. Its board of eight directors has been nominated by the banks.

(3) **Finance Corporation for Industry, Ltd.** This company was also formed in 1945, to provide temporary or longer period finance for industrial businesses, so that they can be rehabilitated and developed as quickly as possible in the national interest. The capital which is £25 million, and borrowing power of four times that

FINANCING THE BUSINESS UNDERTAKING

Form of Undertaking	Raising the Initial Capital	Liquidity of the Capital	Sources of Additional Capital	Liability	Direction and Management	Number of Members
I. Sole trading concern.	The initial capital is provided by the founder of the business from his own savings and is represented in his books of account as the difference between the total assets and liabilities on the date of commencing business.	This type of undertaking is cheap and easy to form and the capital may be withdrawn at any time at the will of the owner.	1. Profits may be left to accumulate in the business. 2. Additional investments may be made by the proprietor. 3. Outside resources in the form of bank loans and trade credit.	The proprietor is liable for the debts of the undertaking to the full extent of his private estate.	The proprietor himself.	One person.
II. Partnership.	The same as No. 1, except that each partner has his individual capital account.	Relatively cheap and easy to form. The scope and nature of business can easily be changed if all parties agree.	As in No. 1.	Both active and sleeping partners are liable to the full extent of the firm's debts.	Each partner is an agent of the firm and of the other partners, having authority to bind them in the ordinary scope of the firm's business.	May not consist of more than twenty partners, or if it is engaged in banking the number is limited to ten.
III. Limited Partnership.	The limited partner invests a specified amount in the firm without incurring an ordinary partner's liability towards creditors.	The limited partner may, with the consent of the general partners, assign his share.	The limited partner may increase his original investment with the consent of the ordinary partners.	The general partners are liable to the full extent of the firm's debts.	General partners have practically a free hand to conduct the business as they like without the interference.	As in No. 2 except that there must be one or more general partners and one or more limited partners.
IV. Private Limited Company.	Appeal to the public for capital is prohibited.	Transfer of shares restricted.	Capital may be provided by allowing profits to accumulate in the business usually in the form of reserves.	There is a limited liability.	All administrative power is vested in a board of directors, who are elected by the shareholders and must obtain qualification by taking at least one share.	There must be a minimum of two members. The maxmum is fifty, exclusive of past and present employees.
V. Public Limited Company.	A general appeal is usually made to the investing public for subscriptions.	The shares are freely transferable.	It is in a better position than any other form of business organisation to obtain fresh capital.	The members are liable only to the extent of the unpaid portion of the shares they hold, or the amount they guarantee.	As in No. 4.	There must be seven or more members.
VI. Co-operative Retail Society.	Capital contributed by members who are also the customers.	The capital is changed by the admission and withdrawal of members.	1. Through accumulation of reserves. 2. By the admission of new members. 3. By loans from the C.W.S. bank.	The Societies are registered with limited liability under the Industrial and Provident Societies Acts, 1893 to 1954.	Under the direction of committee of management with the assistance of paid officials.	As in No. 5.
VII. Nationalised Industry.	Capital obtained by issue of Government securities.		Proceeds of government loans or taxes may be used to increase finance.		Board or Executive responsible for management reporting to appropriate Ministry.	

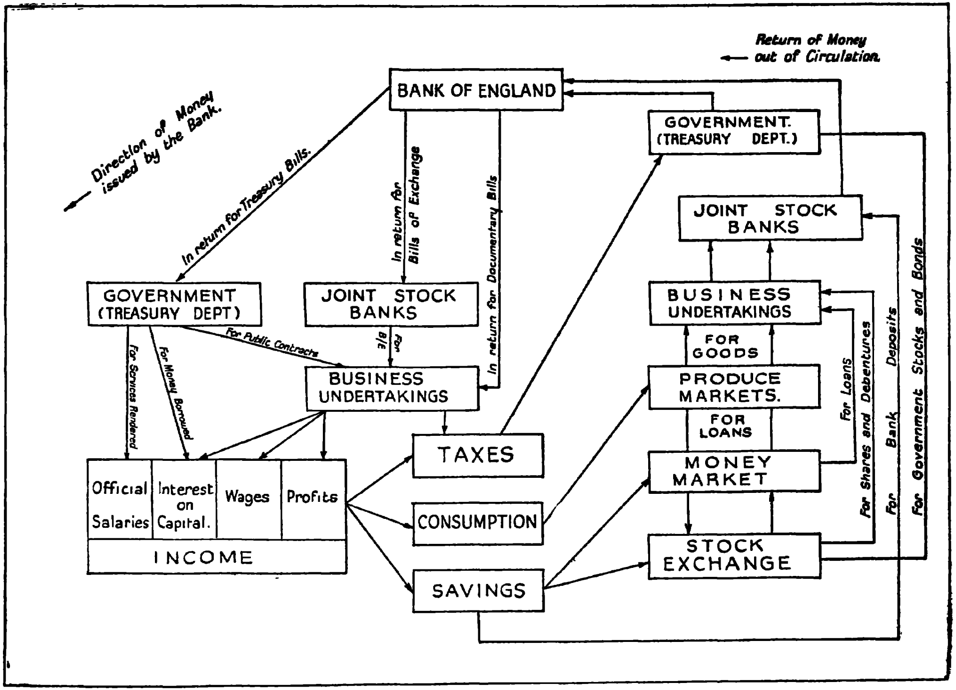
amount, is subscribed by the insurance companies, the investment trust companies and the Bank of England in about equal proportions. Loan capital can also be supplied to the company by the clearing banks and the Scottish banks.

(4) **Special Areas Reconstruction Association, Ltd.** This was registered in June, 1 with a nominal capital of £1,000,000 to assist in the establishment or development of industries in the Special Areas. Advances are limited to a maximum of £10,000 in the case of any one loan. No capital is subscribed by the State, but assistance is given in the form of a contribution towards management expenses, and of a guarantee against losses of approximately 25 per cent of the total loans made.

THE BANK OF ENGLAND AND THE MONEY MARKET.—The Bank of England, in the discharge of its function as a central bank, must control the structure of money and credit of the country in the interests of financial stability. The control of the circulation of legal tender money operates through the provisions of the Currency and Bank Notes Act, 1928. Much more important, however, under modern conditions, is the control of the credit position, which is achieved through what is known as the Bank Rate Policy supplemented by Open Market Operations. Bank Rate may be defined as the minimum rate of discount charged by the Bank to the market for the discount of bills of exchange of an approved type. The type of paper eligible for discount remains at the discretion of the Bank, but its requirements are in practice rigidly fixed. The only bills it will consider are those bearing at least two British names of first-class standing, one of which must be the acceptor. The rate is fixed every week at a committee meeting of the Bank directors held on Thursday, and is communicated to the market. Movements of the rate depend entirely upon the decisions of this committee, in the light of the information at their disposal regarding the financial position and outlook. No explanation of policy is offered to the public—a fact which has given rise to much bitter criticism.

The importance of the Bank Rate lies in the fact that it forms the foundation of all other rates in the market. Thus, the official rate of interest charged by the commercial banks on loans and overdrafts is fixed at about 1 per cent above Bank Rate, with a minimum of from 4 to 5 per cent, whilst the rate of interest which they allow to their customers is about 2 per cent below Bank Rate. At the

THE BANK OF ENGLAND AND THE MONEY MARKET



In the diagram the arrows indicate the direction of the flow of currency from the Bank of England through the various channels of the economic system. In return for Treasury Bills, bills of exchange, and other securities, the Bank issues legal tender money, which is used for the payment of taxes, commodities, and for investment; ultimately it returns to the Bank, where it is cancelled after having functioned as a medium of exchange.

same time, the rates for call loans and the market rates of discount are also fixed roughly in proportion to it. Hence, a change in the Bank Rate tends normally to cause a change in the entire structure of interest rates in the market. Thus, supposing that the Bank considers that a contraction of credit is desirable, it will take steps to implement this by raising the Bank Rate. At once the joint stock banks will increase their deposit and their loan rates, since if they do not raise the former, funds may be withdrawn from their custody to seek more profitable employment. An increase in the deposit rate will tend to attract funds to the bank in order to earn the higher rate of interest, thus preventing them from being employed in other directions. At the same time, those who operate with borrowed money, such as members of the stock market, find that, owing to higher interest rates, their margin of profit is curtailed or wiped out entirely, so that they operate less freely. Discount rates in the money market will also harden, since the discount houses and bill brokers can borrow only on less favourable terms.

The contraction of credit tends to have a deflationary effect upon prices, which show a downward movement. This, in turn, may have the effect of stimulating buying in the home market and so affect the balance of commodity trade. Exports are encouraged whilst imports are checked, and the alteration in the direction of the demand for the means of payment will tend to turn the exchanges in our favour. In any case, the increase in interest rates is likely to attract short-term capital from abroad for investment in London, and this will operate to turn the exchanges in our favour.

Under the operation of a gold standard, the movement of gold in and out of central bank reserves is one guide to Bank Rate policy. If a central bank is losing gold through unfavourable exchanges, the raising of Bank Rate will operate to correct the exchange position and to check the outflow of gold, or even to draw gold from foreign centres to strengthen its reserves. Under existing conditions in this country this index no longer exists. Indeed, for some time now, changes in the Bank Rate alone have not been sufficient to bring about all these effects, and other measures of control have been brought in to supplement the Bank Rate changes.

One of these is the *Open Market* policy. The Bank always holds a large amount of securities as an investment, and quantities of these

would be offered for sale in the market. If the Bank were to sell securities in this way, the total of bankers' deposits is decreased, and the joint stock banks are obliged to curtail their advances and raise their rates for making them. By using this device to reinforce Bank Rate policy, the central bank possesses a most effective means of credit control over the market.

TEST PAPER

1. "The London money market has long been recognised as the most comprehensive and highly organised of the world's financial markets." Why?

2. Enumerate the principal institutions which constitute the London money market. How does the money market differ from the capital market?

3. The requirements of a successful financial centre are said to be: (*a*) ample capital resources to lend abroad; (*b*) adequate banking organisation; (*c*) freedom of the financial market; (*d*) an investing public willing to acquire and keep foreign securities; (*e*) a stable currency; (*f*) a good money market; (*g*) a good foreign exchange market. To what extent do you consider the City of London fulfils these requirements? Give reasons for your answer.

4. Write brief notes on the following: Underwriters; Investment Trusts; Finance Companies.

5. What is the structure of the "long-period capital market" in England? Bring out clearly the functions of the different agents engaged in the creation and transfer of long period securities. What possibilities of abuse and waste are inherent in the market?

6. What recent developments have taken place in the development of industrial finance? In your answer bring out the function performed by Securities Management Trust, the Industrial and Commercial Finance Corporation, and Finance Corporation for Industry, Ltd.

7. From a study of the table on page 454, state the chief methods of financing the business of a sole trader, a joint stock company, and a co-operative society.

8. How does the Bank of England control the structure of money and credit of the country in the interests of financial stability?

9. The Enterprise Engineering Co., Ltd., was incorporated in 1934 with a capital of 10,000 £1 ordinary and 5,000 6 per cent preference shares which were all taken up. The directors expect a very large increase of business during the next few years, and desire to obtain more capital. They possess powers under the memorandum and articles to issue more; but desire your advice (as secretary) as to the best method of securing additional finance.

Draw up your report to the directors setting forth different methods of obtaining this and stating what methods you recommend and why.

10. Give an outline of the purposes served by finance in the realm of commerce. How is the supply of long period capital generally furnished by financiers?

11. Write brief explanatory notes on *four* of the following: Money at call; Treasury Bills; acceptance houses; discount market; over-riding commission; bank rate; open market policy.

CHAPTER XLV

The Stock Exchange

As an institution, the Stock Exchange is important in itself, as being the central market for the purchase and sale of all kinds of securities, but it is also an interesting example of business organisation.

The Stock Exchange is usually referred to as if there were but one exchange, viz. the London Stock Exchange. There are, however, Stock Exchanges in the capitals of most countries, and there are in this country quite a number of subordinate Exchanges at the chief provincial centres. In a sense, all of these Exchanges work quite independently, being entirely distinct organisations, but, in another sense, they work together just in the same way as other business houses work together, occupying the respective positions of customer and supplying house. In the case of the Stock Exchange, however, they take it in turn to act as customer. On the outermost fringe of all, there are unattached dealers in stocks and shares who belong to no recognised society and are bound by no rules.

LONDON STOCK EXCHANGE.—During the eighteenth century stock jobbers transacted their business in the coffee houses of Change Alley and later in their own premises at the corner of Sweeting Alley in Threadneedle Street. The present building, situated in Capel Court between Throgmorton Street and Threadneedle Street, was erected in 1801. The constitution was laid down in a Deed of Settlement signed in March, 1802. A Board of Directors known as the Trustees and Managers was responsible for the management of the building and the collection of subscriptions. These nine members only looked after the interests of the proprietors and had nothing to do with the buying and selling of stocks and shares. The actual business of the Stock Exchange was controlled by the Committee for General Purposes, which consisted of thirty members elected annually. This Committee interpreted the rules of the Exchange and examined members' complaints. This system of dual control, which lasted for more than a hundred and forty years, came to an end in 1945.

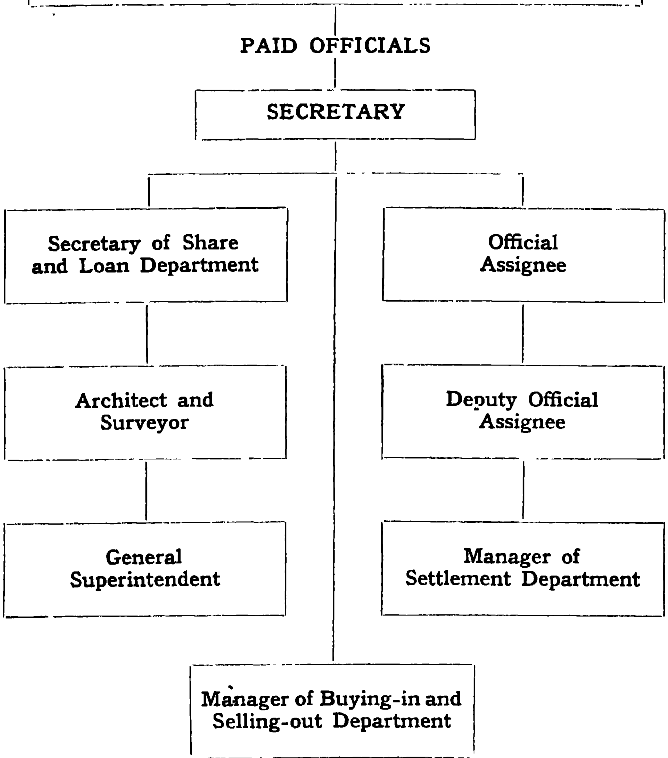
LONDON STOCK EXCHANGE

Council of the Stock Exchange

9 foundation members
27 ordinary members

FUNCTIONS

1. Control the Stock Exchange buildings.
2. Control paid staff.
3. Fix subscriptions and fees.
4. Admit members and authorised clerks.
5. Give authority for arbitrage business.
6. Suspend or censure members.
7. Readmit defaulters.



In March, 1945, the Trustees and Managers and the Committee for General Purposes were formed into a single governing body known as the Council of the Stock Exchange. The Council consists of nine "foundation" members elected by the proprietors and twenty-seven "ordinary" members elected by the members of the Stock Exchange. One-third of the "ordinary" members retire each year. The present membership of the Stock Exchange is about 4000.

The London Stock Exchange differs from provincial Exchanges in this important respect—that its members are divided into two classes, called brokers and jobbers, in just the same way as the members of the legal profession in England are divided into barristers and solicitors. It is only within recent years that the precise distinction between a broker and a jobber has been accurately observed, but now the regulations are more stringent.

STOCK-BROKER. A broker is a member who acts as agent for others in connection with the purchase or sale of shares. He is allowed to act as agent for any member of the general public, or for another member, including a jobber. Ordinarily, his duty is to act for a client who is a member of the public, and he is engaged either to sell to a jobber securities belonging to that client, or to purchase from a jobber securities which his client is desirous of acquiring. But a broker may act on behalf of another broker, or on behalf of a jobber. The need for one broker to act for another does not seem to be obvious on the face of it. The reason is, to enable the broker on whose behalf he is acting to operate with greater secrecy as to what he is doing for the time being. The need for the broker to act on behalf of a jobber is that jobbers, being competitors, will not usually deal for each other.

STOCK-JOBBER. The jobber does not act as an agent, but as a principal. He buys securities which are offered to him, and sells securities of which he is possessed at the time, or which he believes he will be able to buy in time for the date fixed for delivery. He does not necessarily own what he sells, just in the same way as an ordinary trader often books an order for goods which he has not got in stock. Many persons seem to think that it is very wonderful that this should exist in Stock Exchange transactions, although the case is very similar in other branches of trade. The only essential difference is that, in connection with Stock Exchange

operations; the rule as to punctual delivery on the appointed date is much more strictly enforced than in the case of other kinds of trade.

Formerly, jobbers used to deal direct with provincial brokers, but now they are not allowed to do so, since a provincial broker cannot possibly be a member of the London Stock Exchange—to be a member, one must practise within a short distance of the Stock Exchange itself. A member cannot even have his office in the West End, and this, perhaps, seems somewhat strange. The idea is that if a good market is to be established, the members must all be together, so as to facilitate free and rapid intercourse between them.

AUTHORISED CLERK. A broker's or jobber's staff comprises two groups: those who are engaged in the highly skilled technical work associated with stock and share dealings and general office routine, and those who are concerned with work inside the Stock Exchange. The latter are subdivided into "Authorised" and "Unauthorised" clerks, the former having the authority of his principals to enter into transactions on their behalf, and the latter lacking such authority but engaged in various useful functions connected with his principals' business.

Thus an authorised clerk is a person elected as member of the Stock Exchange to act there on behalf of his principal. No member may employ more than one such clerk.

An unauthorised clerk is one who is permitted to enter the House as a privilege, but is not entitled to act and make bargains on behalf of his principal. Two such clerks may be employed by each member, but no more.

NATURE OF STOCK EXCHANGE BUSINESS.—The Stock Exchange has been referred to as a market in securities, and these are loosely known as stocks and shares. Broadly speaking, these may be grouped under two categories—

The *first* consists of a group of securities which represent the loans issued by public bodies.

The British, Colonial, and Foreign Governments, provincial governments, municipal corporations, and all similar bodies raise money from time to time by borrowing. In exchange they give a form of acknowledgment of the indebtedness which has been given, in varying degrees, the quality of marketability. Sometimes the acknowledgments are what the law calls negotiable instruments

(i.e. they may be passed from hand to hand) and possession is legal proof of ownership In other cases, the ownership for the time being is registered. If the owner has nothing in his own hands as proof of possession, they are said to be inscribed stocks; before the Second World War all British Government securities were inscribed stocks. The proof of ownership of inscribed stocks is the fact that they are registered in the name of the owner in the books of the bank which acts as registrar of the stock.

Other forms of acknowledgment of indebtedness are a sort of compromise between the bearer securities, which are negotiable, and the inscribed stocks. A certificate of registration is sometimes issued to the owner, and this has to be surrendered when it is desired to record a change of ownership in the register of the undertaking. These certificates, although issued to the owners from time to time in this way, are not proof of ownership. Here, the proof of ownership is the registration, as in the case of inscribed stock. But, with regard to registered stock, the certificates have to be handed over to the purchasers of the stock, whereas, in the case of inscribed stock, the seller has an entry made in the books of the registrar, transferring ownership.

In the case of bearer stock, the documents are simply passed from hand to hand without any registration.

These are three different kinds of securities representing local indebtedness. They are not necessarily securities in the business sense of the term (i.e. that they convey any sort of rights such as those of a mortgagee to enforce payment if there should be default).

The *second* main form of securities is in respect of different kinds of capital issued by public companies, however incorporated, whether by special Act of Parliament at home or abroad, or by registration under the law of the country where they are registered. Such companies may, subject to the laws which govern them, issue capital in practically any form. Accordingly, they issue different kinds of shares, whilst some of them issue stock—which, for all practical purposes, is of the same nature as paid-up shares—and sometimes debentures or debenture stock. All these securities may be dealt in on the London Stock Exchange. This does not mean that every conceivable kind of share is capable of being bought and sold there, but that it might be if the conditions were favourable.

It is clearly a great advantage to investors that their investments should possess the quality of marketability, the power of being sold or turned into money at short notice. It is also an advantage to those who seek to raise capital by these securities that they should be able to attach to them the quality of marketability, for the issue can then be made more easily and on more favourable terms.

Official Quotation. Generally speaking, almost any kind of security might be dealt in on the Stock Exchange, but there are various ways of dealing in them. For instance, what might be called the highest group in order of marketability are those securities which are officially quoted, that is to say, those securities the prices of which are published on the official list of the London Stock Exchange, which is issued daily and may be purchased by such of the public as care to pay the price for it. Its circulation is not large except among the members of the Stock Exchange, to whom accuracy is of great importance.

In order that securities may be officially quoted, the concern issuing them must comply with certain formalities. It is not necessary here to consider those formalities, since they are altered from time to time by the Council. Generally speaking, however, it may be said that with regard to issues for public authorities (i.e. Central or Local Government stocks), a quotation will never be granted in respect of any loan issued by a Government at war with England. This has always been the rule, and, accordingly, the German War Loan could never be quoted on the London Stock Exchange as long as that nation was at war with us. A quotation may also be refused to authorities which have defaulted in the payment of interest; and that is not by any means an uncommon occurrence. Certain American States have no quoted loans in this country, owing to the fact that they have made defaults in the past.

As regards business concerns, the general tendency of the regulations leading up to an official quotation is as follows. It must be a concern of sufficient size to be of public interest, and, usually, the minimum amount of capital upon which a quotation will be granted is £30,000. This does not mean that the company must have a capital of not less than £30,000, but that the class of shares for which a quotation is required must be not less than £30,000.

One of the reasons why it is practicable to quote prices and have

a market in a certain class of securities is that there are a large number of such securities in existence all carrying precisely the same rights. If every share had a different right, or different characteristics, as in the case of many commodities, such a quotation could not exist.

So long as there is a reasonable quantity of the security available, there is always a probability of some persons being willing to buy and some willing to sell. Unless such a condition of affairs arises, there cannot be a market in fact, although there may be one in name. It is for this reason that some companies issue shares at a low face value, as in the case of rubber shares issued at 2s. each. In this case, the number of shares created is greater in proportion to the amount of capital issued than it would be in the case of £1 shares. The increased number of shares has a tendency to increase the number of dealings in them. The market price is due to the number of persons willing to buy as compared with the number willing to sell.

The requirements of shares for which an official quotation is desired are—

(1) The number of shares issued must be of reasonable size.

(2) The particular issue must have been publicly advertised, and at least two-thirds of the amount issued must have been bona fide applied for by and allotted to the public.

The Stock Exchange will not give a quotation for shares which have not been offered to the public but which carry similar rights to those publicly offered. This is the case where a vendor takes ordinary shares in part payment of the purchase price. The quotation of the vendor's shares is delayed as a rule for two years, to avoid the vendor's shares being unloaded prematurely upon the public and also upon the jobber. Accordingly, not only is an official quotation granted in respect of the particular class of share of a particular company, but it also specifies the distinctive numbers of the shares to which quotation has been granted, and shares bearing outside numbers will not be accepted on the Stock Exchange as delivery of what has been bought.

If the opinion is formed on the Stock Exchange that there has been fraud in connection with the issue, there will be no official quotation, although the Stock Exchange takes no responsibility for guaranteeing the respectability of the issue.

Apart from these officially quoted securities, there is now a large number of securities which are dealt in on the Stock Exchange but which are not included in the official list. There is nothing to prevent members of the Stock Exchange dealing in securities which are not on the official list.

Method of Dealing. The next point is as to how these securities are, in fact, dealt in. The method adopted by the London Stock Exchange differs from that of the provinces, and is quite different from that pursued in any foreign or Colonial Stock Exchange; that is, in the intervention of the jobber. A broker receiving an order from a member of the public to buy or sell certain shares is under no obligation whatever to execute the order if he does not choose to do so. But, directly he undertakes to do business for a member of the public, he has to incur obligations to other parties to whom he is liable. It is true that, according to law, an agent is not liable for the defaults of his principal, but an agent is responsible for the defaults of an undisclosed principal, and a broker does not enter the Stock Exchange giving the identity of his client. Consequently, the broker becomes personally liable to the other party for those bargains which he enters into on behalf of his clients. He is not legally liable to his own client for the default of the persons with whom he has dealt on the Stock Exchange, because there he is being employed as agent, and he does disclose to the client the name of the jobber with whom he deals. Although he is under no legal liability if the jobber should fail to carry out the bargain, it would certainly be regarded as an unusual thing for a broker to plead non-liability in such cases. If he were in the habit of doing so, he would not be re-elected the following March, since it would not be done by a reputable firm of brokers. Although they are agents, brokers take the liability of the contracts they enter into, and, accordingly, it is considered that the time to decide whether the business should be done is beforehand.

Suppose a member of the public has instructed a broker to buy certain shares. The broker goes into the market, which is subdivided into groups according to the general nature of the securities. The chief of these are—

(1) The *Consol Market*, where British Government Stock, Indian Government Stock, London County Council Stock, etc., are dealt in.

(2) *The Industrial Markets*, which deal in the securities of textiles, breweries, tobaccos, etc.

(3) The *American Market*, which deals in the securities of the United States and Canadian railways, and with a few industrial concerns (e.g. the United States Steel Corporation).

The first step is for the broker to decide mentally to which group the securities which he desires to buy belong. He then makes his way to that part of the Stock Exchange where the jobbers congregate who deal in the particular class of security. In some markets there may be fifty or more jobbers, whilst in securities which are infrequently dealt in there may be only three or four jobbers willing to quote a price. Jobbers may, therefore, be regarded as specialists in certain classes of securities. Some of them deal in a very large number of securities, and others in a comparatively small number. When the jobber is asked by the broker for a quotation, he will state the prices at which he is willing to deal. The broker will not state whether he wants to buy or to sell, and, therefore, the jobber quotes him a double price, say, $4\frac{1}{16} - \frac{3}{16}$. This means that the jobber is willing to buy the securities from the broker at $4\frac{1}{16}$ or to sell them to him at $4\frac{3}{16}$. The mentioning of this price by the jobber operates as an offer to deal either way in a reasonable quantity of stock so long as the offer is prompty accepted. What is a reasonable quantity of stock depends to some extent on the nature of the security, but it will usually be between £100 and £500 of stock as a maximum. If there is any dispute as to what is a reasonable line, the Council decides the question after hearing the parties, and the Council's decision is final, because no member can go to law with another member without the leave of the Council. If the Council is doubtful, it declines to give a decision, leaving the parties free to resort to law.

The jobber is supposed to quote a serious price and be ready to deal upon it, but he is not expected to quote a price at which he will buy or sell unreasonable quantities, because if he were to be liable to big risks, such as to find 1,000 shares in a company which was seldom dealt in, or if he had planted upon him 1,000 of such shares he would make the price wider, and that would not increase the marketability of securities generally, so that the jobber is protected by putting a reasonable limit on the shares dealt in at the named prices. The price holds good if it is accepted at once.

It is no use for the broker to come back to the original jobber after having visited another jobber, for the former would then be able to say that the price had altered in the meanwhile.

Between the above-mentioned prices there is a difference of $\frac{1}{8}$, which is, roughly speaking, 3 per cent. Many persons have the idea that this difference represents the jobber's profit. The position is not nearly so simple as that, for, bearing in mind the great amount of business done daily, there would soon be a rapid increase in the number of jobbers. A jobber may quote a certain price at a time when he may not have stock of that kind at all. If he does not know where he can get such securities, he can decline a price, but if he quotes a price he has to take the consequences. If he knows, or thinks he knows, where he can get this stock at $4\frac{1}{8}$, he is quite willing to sell at $4\frac{3}{16}$. But if he does not know where he can buy at less than $4\frac{3}{16}$, it would mean that he would be doing the deal for nothing, if it is a question of his having to sell. On the other hand, if the jobber is very anxious to buy, he might quote a price which will yield him no profit if the broker wants to deal one way, because he is hoping that the broker will have stock which he is anxious to buy. He has always to be thinking of his book, and the function of the jobber is to undo his business as quickly as he goes along.

Supposing he has no stock at all at the beginning of the day, but he knows where he can get some at $4\frac{1}{16}$. If he buys at $4\frac{1}{16}$ and sells it at $4\frac{1}{8}$, he makes a profit. If he does not know where he can get further supplies, he will have to modify his price. Although he has to modify prices with regard to how he stands, he must remember that he is competing with other jobbers, and it is no use doing business if he quotes entirely different prices from the other jobbers. Sometimes there is such a position, that is, two jobbers standing side by side quoting different prices.

The bargain between the broker and the jobber is supposed to be recorded by each at the time, the record being made in a small, pocket-book known as the Bargain Book, carried by each party. Each makes his own memorandum in pencil. In practice, the jobber does not book his bargain at the time, but he books it when he can.

All bargains are checked the following morning, the usual practice being for the clerks in the offices of the brokers to call round at the

offices of the jobbers and check them. In the meantime, the parties to the bargain have reported their respective deals, and these are checked. Should there be any discrepancy, the parties who did the deal have to be referred to, and if they cannot arrive at an agreement as to what did actually occur, they will probably split the difference. But if they do not agree to do that, they will have to refer the matter to the Council, and the Council decides which of the two parties is right, and what the bargain is which is binding on both of them. It is remarkable how few discrepancies do arise, even in busy times. The kinds of mistakes apt to arise would usually be matters of price. If the prices fluctuate widely, there may be misunderstanding as to what the unit figure was. Mistakes of that kind are usually settled between the parties by splitting the difference. Sometimes the mistake has reference to the quantity of stock dealt in, but that is not a common mistake between the members of the Stock Exchange. It is a much more common mistake between the client and the broker, and sometimes the broker finds that he has bought or sold more stock than the client intended. In this case, if the stock has gone up in value, the probability is that the client will not repudiate the bargain, but will give instructions for the excess to be sold. On the other hand, if the stock has gone down, he will probably repudiate the bargain as regards the excess. Sometimes the broker will carry the whole loss, and at others the parties will share the loss between themselves.

Brokers and jobbers seem to be happy-go-lucky in the way they halve losses, but it must be remembered that they are watching each other all the time. If the opinion is formed by one party that the other is habitually making unreasonable demands, the former will avoid the latter in the future. Although bargains between members of the House are conducted in this trustful way, there is no exchange whatever of stamped documents between the parties. That is not the case, however, with regard to the broker and the public.

The broker advises the client of the business done to his order by forwarding him a contract recording, as the case may be, that he has bought or sold such and such stock on account of the client. The contract note is stamped, and is then legally binding on the parties.

The Settlement. The arrangement of the Stock Exchange

provides that the settlement of bargains shall not take place immediately, but that bargains transacted for a given period shall be settled at the end of that period; and the Council appoints Settling Days, usually fortnightly. The Settlement lasts five days; the first is called "Making-up" or "Contango" day; the second, "Ticket" day, when the brokers' receipts for stocks and shares are delivered; the third and fourth, the "Intermediate" days which are utilized for the preparation of documents; and the fifth, the "Settling" day, when delivery is made of money and shares. Those who have bought are required to pay the agreed price for what they have purchased. The duty of the broker in that case is to pay the jobber, and he receives from the jobber a certificate of transfer in the case of a registered stock. This he has to present for registration, and afterwards must forward the Share Certificate to his client. In the case of *inscribed stock*, the broker and the jobber both meet at the Bank of England, and the transfer is there registered in the books of the bank in the name of the client.

In the case of bearer stock, the jobber hands the securities to the broker in exchange for the money.

Here, again is an example of the trustful nature of the various members of the Stock Exchange towards each other. Although these securities sometimes amount to very large sums, they are usually handed over in return for a crossed cheque signed by the broker or jobber as the case may be. The receiving party is entitled to demand notes, although this would be an exceedingly unusual thing to do.

So far as the position of the public and the broker is concerned, there is not the same high standard of credit as between broker and jobber. The broker does not hand over securities to his client until he has been paid for them, and he expects to be paid for them beforehand, so that he can pay the jobber without being out of pocket.

During the Second World War dealings "for the Account" were prohibited and a cash system was introduced. This meant that bargains had to be settled in five days. The object of cash settlements was to restrict short-term speculation by "bulls" (buyers for a rise) and "bears" (sellers for a fall). Fortnightly settlements were once again permitted as from the end of 1946.

Carrying-over. In many cases it may not be altogether convenient for transactions to be settled by the actual payment of

money on the appointed date. Either party to the transaction has a right to demand a settlement on the proper day, but one of the parties may ask for the transaction to be carried over: that is to say, a client who has bought securities may postpone payment for them; in the meantime, however, he does not receive delivery of them.

The need for carrying over bargains on the Stock Exchange may legitimately arise under various circumstances. Sometimes, for instance, in the case of registered stock it is found impossible to get the regulation signatures at the right moment. When stock is in joint names and more than one signature is necessary, the risk of getting the signatures is increased. Again, sometimes there are alterations on the transfer forms which have not been properly initialled, and this makes for delay. Similarly with regard to the question of payment. A person may buy stock thinking he might pay for them on a particular date, but may have to ask for an extension of time. These postponements are quite legitimate and have nothing whatever to do with speculative transactions. Taking this subject a stage further, it may be supposed that a person knows that in three or four weeks hence he will be in receipt of moneys available for investment. He forms the opinion that if he waits until that period has elapsed, prices will not be so favourable as if he bought in the present. Under such circumstances, it is perfectly legitimate for the investor to buy while the prices are favourable and arrange with his broker to carry over the bargain until such time as he will be able to pay for the goods or securities. Business men are constantly doing this with regard to ordinary trade, so that there is no reason why they should not do it with regard to stocks or any other kind of exchange dealings.

Again, a jobber may sometimes find that he is under a contract to deliver stocks, but, on account of some delay, he is unable to do so. It is, therefore, convenient for him to postpone the date of settlement, or he would otherwise have to buy the stocks for cash and pay a higher price for them than if he were granted an additional fortnight in which to find them.

Up to a certain point, these two kinds of persons—those unable to deliver stocks and those unable to pay for them when delivered—will mutually cancel each other, and then the bargains can be

postponed to the satisfaction of both parties. In other cases, they can be postponed only by calling someone into the breach who is willing to tide things over, and that is what usually happens.

During the War the system of "carrying-over" and dealings for settlement at a future Account were impossible, as all transactions were for cash.

Contango. Suppose, for example, A has bought £1,000 Railway Stock from his broker and it is inconvenient for him to pay for it at the appointed time, so that the transaction is carried over. In such a case, it remains for the broker to find someone who will be willing to advance money on that particular stock, and out of this the account with the jobber is settled. The carry-over operation is then really a matter of the broker borrowing money against stock delivered to him for the person who has agreed to pay. The persons lending under these conditions receive as security for the advance—

(1) The actual stock which passes into their name;
(2) The personal security of the broker;
(3) The personal liability of the client.

Hence, in normal times such loans are fairly well secured.

On the loan, the lender is paid interest at such a rate as agreed upon by the broker, who charges a slightly higher rate of interest to his client to cover himself for his trouble and the risk he is undertaking. This charge which the broker makes to his client is known as *Contango*. So far as the client is concerned, he has postponed the date of payment. Later on, when it is convenient for him to pay back the money which has been advanced against the stock, he will take possession of it in his own name.

Backwardation. As regards the postponement of transactions from the opposite point of view, suppose a broker has contracted to sell stock and finds it is inconvenient to deliver at the settlement. In this case, someone has to be found who owns the particular kind of stock and is willing to lend it. He lends the stock and receives money in exchange. The money represents the security that the stock will be returned to him. On the stock being returned, he has to repay the money; but, for the accommodation, he is entitled to such a commission as may have been arranged between the parties. The rate of this commission depends upon circumstances. If the market is short of stock,

it will naturally be higher than if there were a plentiful supply of stock. The commission is known as ***Backwardation.***

TEST PAPER

1. Describe the functions of the Stock Exchange.
2. Explain the organisation of the London Stock Exchange
3. Distinguish between a stock-broker and a stock-jobber.
4. Into what two categories may Stock Exchange business be divided ?
5. What is meant by an Official Quotation on the Stock Exchange ?
6. What are the requirements of shares for which an Official Quotation is required ?
7. Explain the method of dealing on the Stock Exchange.
8. Explain carefully the following terms—

Dealer's turn	Invisible export
Depreciation	Unfavourable exchange

9. What is meant by the " Settlement " on the Stock Exchange ?
10. " Stock Exchanges are the pattern on which markets have been and are being formed." Comment on this statement, with special reference to the qualities of Stock Exchange securities that make them specially suitable for market dealings.
11. Explain carefully the influence of movements in the Bank Rate on the price of securities on the Stock Exchange. How is trade affected by a low Bank Rate ?
12. Give a short explanation of the following terms—Jobbers' turn, bull, bear, spot dealings, contango.
13. Classify the chief kinds of business transacted on the London Stock Exchange. What is the Official List, and what are the functions of jobbers and brokers respectively ?
14. Do you consider that the Stock Exchange performs a necessary function in the organisation of modern commerce? What criticism or defence would you make of the Stock Exchange speculator?
15. Describe briefly the organisation of the Stock Exchange, and indicate the functions of the two classes of members. What routine must be followed on the sale of the following types of stock: (*a*) Inscribed Stock, (*b*) Registered Stock, (*c*) Bearer Bonds?

CHAPTER XLVI

SPECULATION

"SPECULATION" is one of those words concerning the precise meaning of which there is some uncertainty. In the study of commerce, however, it is necessary to attach definite meanings to the terms used, or it will be difficult to avoid giving impressions different from those intended.

In connection with trading operations, there are three distinct grades of speculation—

(1) Legitimate business.
(2) Speculation proper.
(3) Gambling.

These three grades may be regarded as the positive, the comparative, and the superlative degrees respectively.

LEGITIMATE BUSINESS.—This does not by any means necessarily mean that one's operations are entirely without risk, although it might be an advantage if that were the case. The idea of any kind of business being free from all risks is inconceivable, but operations may be said to be conducted on the lines of legitimate business when the risks involved are limited to those risks which are necessarily incidental to that kind of business. As to whether risks are, or are not, incidental to a particular business must be decided in this way. The man who occupies himself with a business which he fails to understand is running serious risks which are not incidental to the business; but the person who makes himself conversant with everything that appertains to the particular form of undertaking in which he is engaged is more or less of a specialist, and is able to meet with ability and equanimity all those risks which it is inevitable that he should come across in the course of his career. He is dealing with problems he understands; and so long as he confines himself to his own class of business, the risks incidental thereto ought not to be overwhelming.

For example, a cotton spinner who buys his cotton forward and sells his yarn under the same conditions is performing a legitimate operation. He is making sure of his profit in advance and is not running the risk of movements in prices which may turn out to

his disadvantage. He is also performing essential services in that he is providing steady work for his workpeople, whilst the operation itself tends to keep prices stable in his particular market.

SPECULATION PROPER.—Speculation, properly so-called, is something which is not altogether disconnected with a person's own business, but is certainly not inseparably bound up with it. The word indicates "looking about." Speculations are those things which a person picks up when travelling about with his eyes open: that is really the meaning of the word. In the course of his legitimate business, a trader may come across opportunities which are not necessarily connected with his own line. If he grasps these opportunities because he thinks they will be advantageous, that is speculation. For instance, it is a speculation when a solicitor invests considerable sums of capital which are, in part, his own, because he learns that certain property is for sale at prices which strike him as being unusually low. Dealing in house property is much more speculative for a solicitor than for a retired builder who has been connected with that occupation. Thus, a speculator knows something about the things in which he deals, although not so much as he ought to know to be able to reap the best advantages.

GAMBLING.—On these lines, gambling may be defined as an operation in something of which a person has little, if any, knowledge. He enters into it blindly because he learns that it may prove to be a good thing, or because he sees that other persons have made money in the same way.

Any extensive gambling in any particular direction is a disturbing element in what might, in the ordinary course of events, be a legitimate business. There are, of course, some forms of gambling which, under no circumstances, can be regarded as legitimate business, such as the operations at Monte Carlo.

By observation and knowledge of the affairs with which they are concerned, business men can to a large extent anticipate the probable trend of future events in the matter of supply and demand. They know by experience when prices are likely to rise and likely to fall. It is true these forecasts are not always correct, but business men are able to build up an experience upon these lines which enables them to make a living out of those operations. Speculation disturbs them to some extent, because

persons not connected with their business step in and take part in it. Gambling is a far greater disturbing factor, because, as a rule, if it occurs at all to any observable extent, it will occur to an extent which dominates the situation. The most prudent business man is as prone to be thrown off his bearings by gambling operations as anybody else.

As a rule, an epidemic of gambling is likely to succeed a period of prosperity coupled with low money rates. If there is money awaiting investment, and legitimate investments stand at prices providing somewhat poor yields, there is a temptation to gamble with the money until more favourable opportunities of investment arise; and if the conditions are favourable to gambling, one may be sure that sooner or later gambling will arise. No one can foresee the exact date when it will begin or the exact intensity it will reach, nor the precise form that the mania will assume.

Whether one is dealing with gambling, speculation, or legitimate business, risks are necessarily involved. The business man cannot avoid risks by confining himself to his own class of business that he understands: all that he can do is to limit the risks to those with which he is more or less conversant, so that he is less likely to be taken unawares.

"BULLS" AND "BEARS."—Sometimes persons enter into Stock Exchange or Produce Exchange engagements without any intention whatever of completing their bargain. What they propose to do is to carry forward their accounts and then undo their business at a profit. They have reasons for thinking that the particular stock is going to rise or fall in price, so that they will be able to sell or buy at a profit. These transactions are clearly speculative transactions. On the Stock Exchange, they are spoken of as *Bull* transactions and *Bear* transactions respectively. Thus, by persistently bargaining to *sell* stock which he has not got, the "bear" tends to force prices down. On the other hand, the "bull," by engaging to *buy* more than he can pay for, tends to raise prices. When two sets of dealers are operating against each other in the same stocks, the "bear" is frequently at the mercy of the "bull" when "settling day" arrives. By his continual contracts to buy, the "bull" may have got control of all the available stock of that particular kind, so that it is impossible for the "bear" to deliver what he has bargained to sell. Hence,

he is compelled either to acknowledge his inability to deliver or to purchase enough stock to enable him to complete his contract at whatever price he can get it. On the other hand, the "bull" may be the victim when the "bear" has effectually lowered the price of the stock and may be able to procure what he has contracted to sell at a price some points lower than that at which he sold.

Take an example of such a speculative transaction: On the 1st November, A sells to B for account—which is on the 16th November—Costa Rica Loan at 79 per cent, the market price at the date of sale being 79¾ per cent. This is, in reality, a speculation on the part of A that on or before the 16th November the price of this particular stock will be 79 per cent or less. If it falls below the agreed price, say, to 78⅞, B has lost, and must then pay A ⅛ (or half a crown) per cent on the amount of stock for which he bargained. If the stock does not fall so low as the price agreed upon, but stops, say, at 79½, A must pay B ½ (or 10s.) per cent on the quantity. This is known as paying the *difference*.

It is well to bear in mind, however, that both "bulls" and "bears" do serve a useful function, or they would have been abolished long ago. They help to steady prices.

An investor in a concern becomes very nervous when an adverse year is experienced and little or no dividend is declared, and hasty selling might result in a drop in prices altogether out of proportion to the real value of the shares; with disastrous consequences to the holders and to the credit of the company. Similarly, artificial inflation might take place with equally disastrous consequences to the buyers of the securities. Bull and bear operations help to steady prices by putting a certain amount of check on violent fluctuations.

When the shares are unduly high, "bear selling" takes place in anticipation of a fall. This acts as a deterrent to artificial inflation, and then, when the reaction sets in and the prices fall, the "bears" cover their transactions by purchasing the shares at the lower prices. Consequently, "bear selling" prevents prices becoming unduly high, and "bear covering," or purchasing, prevents prices becoming ruinously low.

The position of the "bear" is a most difficult one. A very rich man might easily be ruined in undertaking to deliver a

comparatively small amount of stock which cannot be bought. On the other hand, the worst that can happen to the "bull" is that the stock which he has bought may fall down to zero. While the "bull" or "bear" operator is merely anticipating price changes which will happen anyway, he can make himself a profit without harming others—indeed their activities will reduce the peaks and depths to which prices would go without their activities.

FUTURES.—There are many kinds of business which are dependent for their success on some one or two raw materials, the annual supply of which is not certain. The cotton industry of England, for instance, is dependent for its prosperity upon the existing supply of raw material, which, in its turn, depends to some extent upon the harvests. In almost every business there will be some factor of supreme importance which determines to a very large extent whether the profits for the year will be exceptionally good or exceptionally bad, or merely average.

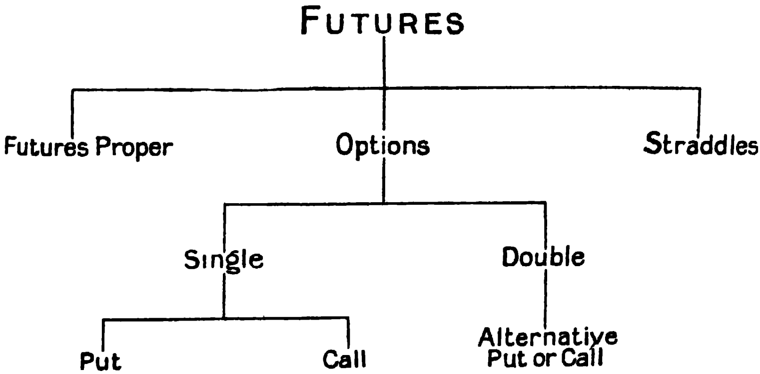
Against these exceptionally bad years, one can usually safeguard oneself by some form of insurance. The method of hedging to cover a special risk of this kind is not, as a rule, by effecting a policy of insurance, although that might be practicable if it were the cheapest way to arrive at the result. The cheapest way is very often by buying or selling some staple commodity in advance by what is called operating in "futures."

Transactions in "futures" may be regarded, roughly, as a market to enable those who are possessed of commodities which are not capable of immediate delivery to come into contact with those who want to buy, but do not want delivery at once. Instead of the market being limited to the visible stock actually available at a given moment of time, the market covers the general resources of the season. In that way, there is a wider market which tends to be a more satisfactory one, because it is not so subject to fluctuations.

Many persons have the idea that dealing in "futures" in cotton, iron, wheat, or some other commodity, is purely gambling and nothing else. This is not always the case, however. If a manufacturer knows that during the next twelve months he will want to buy a certain number of tons of iron or steel, he may place an order for that quantity now, arranging a part to be delivered at the end of one month, part in three months, and

part in six months, etc. Although nominally he is operating in "futures," and although possibly he is buying from someone who has not got the goods to deliver to him, all that he is doing is to buy his goods well ahead of immediate requirements, because the present price suits him. If he were getting delivery of the goods, it would never occur to anyone that it was not a perfectly straightforward business transaction. What puts a different aspect on the matter is that the goods are not delivered. But, on the other hand, date of delivery is largely a matter of convenience, and it cannot be said to be a part of the purchase or sale of goods that delivery should be immediate. Very often when goods are actually bought and paid for in cash, delivery does not follow immediately, because it is not convenient. Hence, the question of "delivery" is not conclusive in deciding the legitimacy of dealings in "futures."

It is a very common custom in legitimate business for traders to sell goods first, and then buy them afterwards from the sources of supply. The manufacturer will often enter into a contract for the supply of goods at some future date, and at the time he books the order he has not got the goods in stock. Such a transaction would be speculative if he did not know where he could buy them at a price that would suit him, having regard to the price of the goods he has to sell. If he can place orders to cover his liability to deliver goods in the future, there is nothing speculative about the transaction at all. But if he waits until the time when he has to deliver the goods before he buys them, and runs the risk of the market, then that is speculation. When



the orders are placed in advance, the manufacturer is avoiding undue risks, and is confining himself to a certain profit instead of an uncertain profit or a large loss. Thus, the business man orders goods ahead of the time when he wants them delivered, for the sake of avoiding speculative transactions, and is at least keeping within the limits of legitimate trading.

KINDS OF " FUTURES."—From the diagram on page 479, it will be seen that " Futures " is a generic term embracing the following—

(1) Futures Proper (2) Options (3) Straddles

In each of these cases, a commodity is purchased or sold which does not really exist, and the speculation is on the difference in price between the time the contract is made and the period when the goods are to be delivered.

"Futures" Proper. A " future " transaction is a purchase of goods for delivery at some date in the future at a price settled when the contract is made. Instead of subjecting themselves to the fluctuations of the market, many manufacturers find it expedient to make contracts for future supplies of raw material, and are thus enabled to attend solely to the manufacturing process. In the raw cotton trade, for instance, the market for the raw material is in the hands of brokers whose business it is to study the "harvest" prospects long before it is gathered in. Upon their calculations they base the price of "futures." If their calculations prove correct, they will reap a profit, since they will buy the cotton at the future market price and sell it at the present agreed price, which is much higher. The spinner places an order for the delivery of cotton in the future, because—

(1) He will be sure of having the raw material.

(2) He has to know what to quote to his customers for goods ordered and to be delivered at some later date.

Options. These are arrangements to buy or sell a certain amount of commodities at a fixed price within a limited time. If the arrangement is to buy goods, it is known as a " Call Option," whereas a similar arrangement to sell goods is a " Put Option." For this option the person has to pay a price to the broker.

" CALL " OPTION. This gives one dealer the option of *buying* from another a certain amount of commodities, at a fixed price, within a certain period. For example, a person anticipating a

rise in price of a commodity may offer to buy an option to call for, say, 1,000 lb. of it during the next month at 5d. per lb., the present price being $4\frac{10}{64}$d. per lb., and pays 10s. as consideration money. If the market remains unchanged or falls in price before the end of next month there will be no profit on the transaction. But if the price of a commodity rises above 5d. per lb., say to 6d., he can call for 1,000 lb. at 5d. and sell it at the prevailing market price. In this way, he will make a profit of 1d. per lb. less the amount paid for the right to exercise the option. It will, therefore, be seen that by buying a "call" option, the dealer insures against a future rise in the price of a commodity.

" PUT " OPTION. This is the reverse of a " call " option. It is the right to *sell* at a fixed price a certain amount of a commodity within a certain period. It is an insurance against the price of the commodity falling. Suppose, for instance, the present price of a commodity is $4\frac{1}{2}$d. per lb., and a person pays 10s. as consideration money for the option to deliver at any time during the next two months 1,000 lb. of it at 4d. lb. If the market remains quite steady, or advances, during that period, the option would not be exercised, and the option money would be lost. But if the price of the commodity fell to $3\frac{1}{2}$d. as expected, the 1,000 lb. of it would be delivered at 4d. per lb., and the difference, less the option money, would be profit.

" DOUBLE " OPTION. This is the right to buy *or* to sell a certain amount of a commodity within a certain period, in the future, at a price fixed in the present. It is an insurance against the market price of a commodity moving either way, since the purchaser can either buy or sell. The amount to be paid for such an option is twice that of a single option, and, in consequence, it is but seldom used.

Straddle. This is a speculation on the gaps between the prices of different qualities of a commodity or between the prices of "futures" with different periods to run. For example, suppose a dealer *buys* a commodity which is to be delivered in June or July at 5d. per lb., and *sells* the same quantity of "futures" deliverable in July or August at $5\frac{10}{64}$d. per lb.; then, whether the prices rise or fall as a whole, he gains if the difference between the two prices becomes less than $\frac{10}{64}$d.; but if it becomes more, he loses. On the other hand, had the dealer *bought* July–August " futures " at $5\frac{10}{64}$d. and *sold*

June–July " futures " at 5d., he would have gained in the event of the difference increasing, and lost in the event of its decreasing.

CORNER.—A " corner " is said to be made when a group of speculators have been able to buy up the whole, or a large portion, of the available supply of a commodity, and thus force those speculators who have contracted to sell at a fixed price to buy at a high rate from those who have effected the corner.

HEDGING.—This may be defined as a device whereby a trader or manufacturer uses the machinery of an organised market for the purpose of protecting himself against loss through fluctuations in the price of the commodity in which he is dealing. An actual sale or purchase of a commodity is balanced against an equivalent purchase or sale for future delivery. The mechanism of dealing in futures, with its utilisation for hedging purposes, enables men to shift speculative risks of price almost entirely to a special class, and this class of speculators takes speculative profits as its compensation for performing this economic service. The market in futures, commonly regarded as exclusively a speculative market, really provides in the hedge an effective means of avoiding speculation.

MARGIN DEALING.—This means the purchase of stocks and shares with only a small percentage of the total cost, say 20 per cent, deposited as margin. If £100 worth of stock is bought for a margin of £20, the speculator might sell, say, at £110 and make £10 profit less expenses on his outlay of £20. On the other hand, if the stock dropped to £80, his total margin plus expenses would be lost. This method of dealing is practised largely in the United States and also by bucket shops in this country.

A "bucket shop" is the term used for the office of dealers in stocks and shares who are not members of the Stock Exchange and who generally try to force worthless shares upon the public.

ARBITRAGE IN GOODS.—Arbitrage operations in goods and securities are transactions which aim at profiting by the difference of prices existing at a given moment for a certain commodity on different markets.

When a merchant desires to enter into an arbitrage for the purchase of a commodity, he begins by establishing the net parities, or equivalent cost prices in sterling, of the commodity on the different markets. In calculations of this kind, there are usually two classes of charges to be taken into account: the one com-

prises the percentage charges, such as commission, insurance, etc., which are dependent upon the amount of merchandise; and the other, the fixed charges—as freight, etc.—which attach to the article without regard to its value.

These parities are then usually arranged in the form of a table as follows—

TABLE OF PARITIES

London	23/2
New York	23/-
Odessa	22/-
Antwerp	23/10
Hamburg	23/8

From this table it will be seen that it is to the interest of the English merchant to buy at Odessa. If the merchant desires to sell, he chooses the place where the parity is highest.

In the above illustration, this would be Antwerp.

In Stock Exchange dealings, it frequently happens that the same stock is quoted at slightly different prices at the same time in two different places, say London and Paris. If a slightly higher price rules in Paris, the operator buys in London as much of the stock as he can, and at the same time telegraphs to his correspondent in Paris to sell the same quantity of stock. Hence, if the difference in the prices is sufficiently large, the operator succeeds in making a profit after deducting the necessary expenses. In case the prices were higher in London than in Paris, the operator would sell in London and buy in Paris. In the strict sense, therefore, arbitrage may be defined as a traffic consisting of the purchase, or sale on one Exchange, and the simultaneous, or nearly simultaneous, re-sale or re-purchase on another Exchange, of the same amount of the same commodity.

These activities have been limited since the last war by currency exchange restrictions.

TEST PAPER

1. Distinguish the three different grades of speculation in connection with trading operations.
2. How would you distinguish between "legitimate" and "illegitimate" speculation? Argue the question with reference to some particular market.
3. Point out the distinction between gambling and speculative dealing, together with their respective economic effects.
4. Define "Speculation," and consider how far the speculator performs a useful function in the modern economic system.
5. Explain the uses of "Futures," and indicate any advantages or disadvantages which have followed their introduction.

6. Copy the diagram on page 479 and explain carefully its meaning.
7. Trace the effect of the introduction of "Futures."
8. What is meant by "Purchasing an Option"?
9. What do you understand by option dealings? Give illustrations of different forms of options, and indicate their function as a means of insurance against adverse price changes.

ABBREVIATIONS USED IN EXCHANGE, BANKING AND FINANCE

Acc.	Acceptance; accepted
A.d. *or* **A/d**	After date
Afft.	Affidavit
A.P.	*A protester* (to be protested—bills)
A/S	After sight
Back.	Backwardation (Stock Exchange)
B.B.	Bill Book
B/C	Bills for collection
B.D.	Bill discounted
B/D	Bank draft
B/E	Bill of Exchange
Bk.	Bank; book; backwardation
Bkg.	Banking
B/L	Bill of Lading
B.O.	Branch office
B/P	Bill payable
B/R	Bill receivable
B/S	Bill of sale
C/-	Coupon
Cap.	Capital
C.B.	Cash Book
C.H.	Clearing House
Consols	Consolidated Annuities
C.P.	Charter party
Cum d.	With dividend
Cy.	Currency
D/A	Days after acceptance; Documents against acceptance
D/D	Demand draft
Dft.	Draft
Dols.	Dollars
D/P	Documents against payment
D/R	Deposit receipt
D/S	Day's sight
E/I	Endorsement irregular
Exch.	Exchange; exchequer
Ex cp.	Ex coupon
Ex div.	Without dividend
Ex in.	Without interest
E. & O.E.	Errors and omissions excepted. These letters are often added at the end of an account as a protection in case of wrong entries in the books
H.O.	Head Office
I/I	Indorsement irregular
I O U	"I owe you" in an abbreviated form. It is merely a memorandum of a debt
I.R.O.	Inland Revenue Office
Iss.	Issue
J/A	Joint account
L/C	Letter of credit
£A	pounds, Australian
£E	pounds, Egyptian
£N.Z.	pounds, New Zealand
£S.A.	pounds, South African
£T	pounds, Turkish
M.C.	Marginal credit
M.D.	Memorandum of deposit
M/D	Months after date
M.O.	Money order
M/S	Months after sight
n/p	Net proceeds
N.A.	No advice
N.a.	Non-acceptance
N/A	New account
N/E	No effects
N/F	No funds
N/N	Not to be noted
N/O	No orders
N.P.	Notary Public
N.S.	Not sufficient
O/D	On demand; Overdraft
P.N.	Promissory note
P.O.	Post office; postal order
R/D	Refer to drawer
Shr.	Share
Sovs.	Sovereigns
S.P.	Supra protest
Spec.	Speculation
Stg.	Sterling
T.M.O.	Telegraph money order
T.T.	Telegraphic transfer
x.c.	Ex coupon
x.d.	Ex dividend
x.in.	Ex interest

SECTION VI—TRANSPORT AND INSURANCE

CHAPTER XLVII

Modes of Transport

INTRODUCTION.—The next important section of Commerce deals with Transport and Insurance. In an earlier chapter, Commerce is defined as ***the sum total of those activities which are engaged in the removal of the hindrances of persons, place, and time in the exchange of commodities.*** The first of these hindrances is overcome by the advent of the trader as a specialised person, whose duty it is to act as intermediary in effecting the exchange between the producer and consumer. Hence, the personal hindrance is overcome, since there is no longer any necessity for producer and consumer to come into contact with each other. In a similar manner, the hindrance of "*place*" is surmounted by means of Transport and Insurance. Originally, the merchant furnished his own conveyances and supplied horses and men, and looked after the transport himself. Moreover, he built ships and sent them on his own account and risk to the distant parts of the earth. At that time there was no insurance against piracy, theft, fire, and other contingencies. Any accident to the goods in transit might entail an enormous loss to the trader, and sometimes absolute ruin. With the advent of the railway and the steamship, conditions have quite altered. Letters are no longer dispatched by paid messengers, but through a universal and well-organised State Postal Service. Animals drawing their burdens through the main thoroughfares have almost disappeared, and they have been replaced by motor-driven lorries, which have much greater speed and can convey more goods than countless horses. On the rivers, canals, and inland seas, the restless steam-tug passes from place to place; and giant steamers—capable of carrying enormous quantities of products—traverse the ocean, so that the latter no longer acts as a divider, but as a uniter, of men. Again, if goods are wholly or partially destroyed in course of transit, no

loss is now suffered by the owner, since it is borne by large insurance companies, who recoup themselves out of the premiums paid by the insured. All these and many other facilities have become auxiliaries in the service of trade. Indirectly, it has also called into being the broad roads, and canals, the extensive railways, and the thousand and one shipping lines from and to all parts of the earth. With their increase in complexity, the varying activities connected with transport have gradually separated themselves from trade, just in the same way as banking did in the Middle Ages. Both transport and insurance are now regarded as specialised and independent branches of commerce. A great part of the business of transport has been removed from the sphere of private enterprise, and is now conducted as a monopoly in the hands of the State. After the Second World War road, rail, and air transport in Great Britain were nationalised by the Labour Government, but road transport has since been de-nationalised.

GENERAL CONSIDERATIONS.—The considerations which generally govern the classification of goods for the purpose of fixing the rates of most forms of transportation are—

(1) The value of the goods.
(2) The risk of damage.
(3) The bulk of the goods in proportion to their weight.
(4) The method of packing and the expenses of handling.
(5) The regularity and magnitude of the business done.

The relative importance of each of these five considerations differs enormously in different cases. With regard to some commodities, only one or two of these factors come into operation; whilst, in others, practically all of them must be taken into account.

Value of the Goods. Railway rates and charges are not determined by the cost of carrying the goods themselves, for if that were the case, some goods would never enter into commerce at all, because their price would not admit of the cost of the carriage. Valuable articles can bear higher rates than cheaper articles. For instance, it would make but little difference in the price of first-class furniture whether British Railways charge £10 or £15 for cost of transport, especially where the total value of the goods amounts to several hundred pounds. The cost of the transport will only be a small item in the total cost of the goods, and will affect the price of the article so little, that the demand for it will in no way

be altered. Further, consignments of valuable goods are relatively few in number, since only a comparatively small number of people can purchase the most expensive commodities. Consignments of such articles as valuable furniture do not take place by the train-load as in the case of coal, and, in consequence, they are more inconvenient to transport. Hence, the rates are higher.

Risk of Damage. If damage is incurred by a valuable article, the claim to be met by British Railways is larger than in the case of cheaper goods. The risk of theft is also greater, and a small amount of damage, or theft, might easily absorb the whole of the rate charged. In articles of lower value, the risk is comparatively slight. For instance, if the cost price of an ore is 14s. per ton, and a consignment of 100 tons is sent from the Midlands to London at 5s. per ton, it is inconceivable that a claim can be made upon British Railways for damage done to the ore sufficient to absorb more than a trifle of the railway freight.

Bulk in Proportion to Weight. Another factor determining the rate to be charged for transporting an article is the bulkiness of an article in relation to its weight. Some articles are extremely light, although they take up a considerable amount of space (e.g. a consignment of straw hats). Again, a consignment of coke is usually twice as bulky as coal. A 10-ton wagon will carry about 10 tons of coal, but only 5 tons of coke.

The Method of Packing and Cost of Handling the Goods. The question of good or bad packing influences considerably the amount of risk involved. For instance, cheeses which are well packed will be much less open to risk than those sent loose. The method of packing will also make a difference to the amount carried by each truck. Cheeses packed in wooden boxes can be piled one on the top of the other, whereas those wrapped in cloth can be carried only with difficulty. The method of packing will naturally affect the question of handling. For instance, the difficulty of handling a 10-cwt. consignment of kettles, made up of eight or ten packages of uniform size, is small compared with the same kettles which are sent loose.

In some trades, it is the practice to pack certain grades of goods in particular packages, and the rate charged for conveyance is regulated by the nature of the packing. For instance, in the case of china goods, cases are used for packing only the more valuable

kinds of china, where the breakage of a single article may result in a heavy loss. Second-grade china is usually packed in hampers, whilst the cheapest goods are packed in casks or crates.

The Regularity and Magnitude of the Business Done. Throughout the whole of the railway classification of goods, there is frequent reference to the minimum quantities of goods that may be consigned if the lower rates are to be obtained.

Again, take the case of the importation of foreign produce. Danish produce, for instance, is received in this country in good-sized packages, which can reasonably be handled without breakage. Moreover, the wagons are packed as full as possible, the average load being about 5 tons. On the other hand, a different state of affairs exists in regard to home-grown produce—

(*a*) A very large proportion of the wagons will contain a ton or less.

(*b*) The load may consist of three or four consignments.

(*c*) The average load per wagon in an agricultural district is about 30 cwt.

As far as British Railways are concerned, at least three or four wagons must be used for the same quantity of home-grown produce as for the one wagon for the imported products. Hence, it is only natural that the rates for the latter are smaller.

FORMS OF TRANSPORT.—The chief forms of transport are—

1. Road. 2. Railway. 3. Canal. 4. Sea. 5. Air.

I. **Road.** Transport by road is probably the oldest branch, and records of road-making and transport by wheeled traffic on roads are of great antiquity. By the end of the eighteenth century, in most civilised countries main roads had been developed to a considerable state of perfection; and horse coach services were well maintained. Even this method, however, was relatively slow, and the condition of side roads generally was still very poor. The application of the steam locomotive in the middle of the nineteenth century to the development of railways stimulated the building of railways all over Western Europe; and from 1850 to 1900, road traffic showed a relative decline.

The invention of the internal combustion engine, however, and its application to road transport at the beginning of the twentieth century, together with the further stimulus applied by War needs from 1914 to 1918, resulted in a great revival of road traffic; this necessitated road improvements everywhere, and has led to an

extensive use of this method of transport for relatively short distances, for passengers and light valuable goods.

In addition to private individuals who convey their own goods, road transport is conducted by the *Common Carrier*. A *common carrier* is one who carries goods as his regular business, and who holds himself out as ready and willing to do so for any person who may wish to engage him. The consignor may either hire one or more vehicles and load these as he pleases; or he may deliver separate packages, such as casks, cases, bales, etc., and leave the carrier to complete the load.

II. **Railway.** The most important transport by land is that of the railway. From about 1825 to 1845 there was a rapid increase of *Railway Construction* and development. At first it had been intended to charge private vehicles a toll for using the railway line in a similar manner to that in use for roads, but it was seen that the slowest vehicle set the pace, and it therefore became necessary for the railways to take over the whole direction and management and become carriers of goods. By this means large quantities of freight were dealt with at low rates.

In the succeeding period from 1850 to 1890 a period of consolidation on the railways took place. Acts of Parliament were passed dealing with regulation of working, and conditions of land purchase. Land purchase has been the chief factor in railway capital expenditure; neither shipping nor aircraft having a permanent way to purchase and maintain.

One of the chief of these Acts was the Railway and Canal Traffic Act, 1888, establishing a Commission to deal with technical questions. Until 1900, there was much competition between the various railway companies; but after a time it was realised that freight charges could not be economically reduced indefinitely, and working agreements operating over adjacent districts were formulated. This arrangement was continued, broadly speaking, until the outbreak of the War in 1914. After the War, the Railways Act, 1921, provided for the amalgamation of the main line railways; and some 120 separate companies were merged into four groups. The railways were nationalised under the Transport Act, 1947, and the four companies became "British Railways."

In 1840 there were less than 5,000 miles of railways in the world all of which were located in Europe and America. At the present

time there are more than 700,000 miles distributed over the various continents. More than two-thirds of this total have been constructed since 1880.

The most rapid development has been in European countries and the United States of America, whilst in the last few decades there has been a noteworthy extension in other parts of the world.

This rapid development of the railway system is due to its superior advantages over other means of transit, such as its speed, cheapness, regularity, and its capacity for conveying huge quantities of goods and large numbers of passengers.

III. **Canals.** The first English canal was cut in 1758 by Engineer Brindley, who was employed by the Duke of Bridgewater to make water communication between his coal-mines at Worsley and the mills at Manchester. The cost of coal in Manchester, for example, was halved by the construction of this canal. Such was the success of Brindley's scheme, that for the next forty or fifty years canals were constantly being cut, the last decade of the eighteenth century being particularly remarkable for the mania for canal speculation which seemed to have seized capitalists. Shortly afterwards, however, the railways began to develop speed and this factor began to compensate for weight, and traffic on canals declined. Canals had developed so rapidly because most roads of that period were too bad for industrial purposes, haulage was cheaper, and steam had not then been applied to railways, all transport being relatively slow. Although canals have suffered from the competition of railways, there is one class of traffic in which they will probably never be supplanted: this is the transport of bulky articles not worth the expense of railway carriage, such as coal, iron, lime, hardware, or pottery. They cannot, however, be used for such perishable commodities as fruit, fish, or dairy produce. With the exception of some of the smaller canals, where the rates differ little from the railway rates, these are the advantages of transport by canal: loading and unloading at favourable places on route; less risk of loss and damage; practically unlimited capacity for traffic; and cheaper rates.

The Canal Traffic Act of 1888 established the Railway and Canal Commission, under whose authority a uniform classification of merchandise, similar to that adopted for railways, was made; and uniform maximum tolls and rates were fixed.

Canals in Britain were nationalised by the Transport Act, 1947.

One of the chief drawbacks to canals is that they must always lie on the flat, and inequalities in the ground must be regulated by means of locks, in which vessels can be transferred to a higher or lower level. Sometimes, instead of locks, inclined planes are used, up which the barges are hauled by steam power.

With the development of international commerce, ship canals have begun to play a more and more important part. By means of the Suez Canal, ships bound to and from the East may avoid the long voyage round the Cape of Good Hope. By means of canals, ocean-going vessels are enabled to pass directly from the Atlantic Ocean to the Great Lakes of North America, thus avoiding the Falls of Niagara. A ship canal enables large ships to sail up to the wharves of Manchester, instead of discharging their cargoes at Liverpool; whilst another canal allows vessels to pass from the mouth of the Elbe to Kiel on the Baltic Sea, without rounding the treacherous shores of the peninsula of Jutland. The Panama Canal forms an alternative route to Australia and the East, and saves the long journey round Cape Horn.

IV. **Sea Transport.** Great Britain has for long been the chief sea power in view of the volume of its overseas trade, which has grown with the growth of the British Empire. Moreover, the Merchant Navy carrying trade received a great impetus from the industrialisation of the country between 1750 and 1850, when England became the factory for the world, and needed an immense mercantile marine to carry products to purchasing countries and import raw materials in return. The continued depression in foreign trade since the First World War resulted in a great reduction of these activities. Nevertheless, the long start obtained by Britain in this matter enabled her to keep ahead of competitors; and the British Mercantile Marine in active service is to-day still the largest in the world. The U.S.A. has a larger fleet if the tonnage of shipping "in reserve"—i.e. not in active use—is included.

THE REGISTRATION AND MEASUREMENT OF SHIPS. The registration of ships is a means of providing a permanent record of a nation's mercantile marine. The owner of a British ship must register it at a port within the British Empire, which is known as the port of registry. When the ownership of the vessel changes hands, this fact must be endorsed on the *Certificate of Registry*.

This is a document signed by the Registrar of the port to which the vessel belongs, and usually specifies the name of the vessel, her tonnage, etc.; the name of her master; particulars as to her origin; and names and description of her registered owners. It is the evidence of the nationality and identification of the vessel.

The measurement of ships aims, first, at determining the total capacity of vessels, for upon this is based, to a large extent, the carrying capacity, as well as the port and canal dues which will have to be paid. The total capacity of each ship is officially measured and is expressed in *registered tons*—1 registered ton being equal to 100 cub. ft. The registered (or Board of Trade) ton is, therefore, based upon measurement and not weight. This total capacity of the vessel is known as the *gross tonnage*. The net tonnage is obtained by deducting from this figure the space occupied by the boilers, coal bunkers, and crew accommodation. Every ship has, therefore, two tonnages—a gross and a net.

CLASSIFICATION. All ships are not all equally seaworthy. The degree of seaworthiness is, however, of great significance to the consignor of the goods and also to the insurer. According to their seaworthiness, ships are classified. This is effected not by Government officials, but by private companies, such as Lloyd's Register of British and Foreign Shipping in London, the "Bureau Veritas" in Paris, and the Germanic Lloyd in Berlin.

The class into which a vessel is placed is indicated by definite symbols, which differ in each country; but in each case it is an indication of the efficiency of the vessels with regard to their age, construction, and seaworthiness.

THE SHIP'S MANIFEST. Every vessel, whether upon an outward or a return journey, must carry a manifest. This is a list of the vessel's cargo, and is usually signed by the shipbroker who clears the vessel out at the Custom House, and by the Master. It must contain—

(1) The names of the shippers and consignees.

(2) The marks and number of each separate package.

(3) A specification of the quantity of goods contained in each package (e.g. rum, sugar, etc.).

(4) An account of the freight corresponding with the bills of lading.

Should the vessel be calling at several ports, the goods for each place must be shown on the Manifest.

SHIPPING COMPANIES.—Two-thirds of the ships being built in the world in 1914 were under construction in British shipyards. As soon as the War broke out, sailings from Great Britain were held up because no insurance company would undertake to insure against war risks and owners would not allow their vessels to go out uninsured. The Government, therefore, undertook such insurance itself, and this meant that the Government had to bear the brunt of shipping losses during the War. Until 1920 shipping continued to flourish; then with the commencement of the great depression, the demand for ships declined. This affected all countries, especially the United States. The Americans had built many ships during the War and took full advantage of the war-time demand. By 1921 the Americans, with their high rate of exchange, were unable to compete with other countries. British shipping was also badly hit and ships were sent to lie out in the mouths of rivers. This naturally affected shipbuilding because, if the ships already in existence could not be used, there was no point in building new ones. Another difficulty was that foreign nations were taking more interest in shipping. For example, there was Japan with her N.Y.K. (Nippon Yusen Kaïsha). Italy also went in for shipping; the Greeks bought large numbers of old ships; the Scandinavian countries and France also took a renewed interest in shipping. Germany once more went in for the North Atlantic passenger liners—the *Bremen* and the *Europa*. In the meantime, however, the White Star Line was sold to British interests and finally merged with the Cunard Company.

British shipping to-day can be conveniently regarded by its grouping. The tendency since the First World War has been for individual companies to combine, and five great groups have resulted, with a few companies still remaining independent.

The five great groups are—

(1) *The Kylsant Group*, which centres round the Royal Mail Lines and maintains services to South America, the West Indies, and the North Pacific. Numerous well-known lines are associated with it.

(2) *The Inchcape Group*, of which the Peninsular and Oriental and British India lines are the predominant partners. Both are interested in the Indian, Eastern, and Australian trades, the British India maintaining East African services in addition.

(3) *The Furness Withy Group*, which includes a large number of

minor companies for agency purposes, and also a number of important regular lines. Originally its interest was confined almost entirely to the North Atlantic trade, but the activities of the group now extend all over the globe and it possesses some of the finest cargo tonnage afloat.

(4) *The Cunard Group*, which includes the various North Atlantic and Mediterranean services of the Cunard line itself, as well as a number of lines interested in the Australian, New Zealand, and South African trades.

(5) *The Ellerman Group*, which extends its activities all over the globe either by itself or in conjunction with other concerns.

In 1934 the Government agreed to give an annual subsidy of £2,000,000 to British tramp shipping on condition that the industry put forward a suitable scheme to prevent the subsidy from being dissipated on domestic competition. The British Tramp Shipping Committee evolved a scheme, and it was agreed that the subsidy should cease as soon as freight rates reached the level. The Government subsidised tramp shipping until During the Second World War a considerable part of British shipping tonnage was lost by enemy action. Since the war the shipbuilding industry has been thriving, and shipowners generally have been enjoying a period of prosperity.

V. **Air Transport.** Of increasing significance is the conveyance by aeroplane of passengers, mails, and goods. The enormous development of aviation during the First World War suggested possibilities of more rapid transport in peace time. A London-Paris Air Mail was introduced in 1919. The result was disappointing, and showed that for short distance services the air service offered little advantage in comparison with the extremely efficient alternative means of land-sea transport. Actually in the London-Paris service carried little more traffic than ten years before, in spite of an extremely low rate and a very efficient service.

In this country transport by air was somewhat slow in its initial stages. A long distance service naturally involves liberty to fly over all the intermediate countries on the route, and international agreements, which make this possible, took time to negotiate. It became increasingly clear that, without some substantial degree of subsidy, real development of civil aviation was out of the question, and at last, in 1924, a number of separate companies were merged

into a single company—Imperial Airways—to which the Government agreed to give a monopoly of government subsidies, and an agreement covering operations for ten years. This agreement was a great landmark in the history of British civil aviation.

At the outset Imperial Airways mainly confined themselves to the development of traffic with Europe, but it became more and more obvious that the real value of air services lay in their use over very long distances, and that, in view of the special conditions of the British Empire, with Dominions and Colonies at distances of from two to twelve thousand miles from the Mother Country, there were great possibilities, political, social, and commercial, in this new and rapid means of communication. Obviously an enterprise such as that of linking up the Empire must be developed by degrees, and on a survey of the position it seemed that the strongest case for the initial experiment was the service between Great Britain and India and thence to Australia. A regular service between Great Britain and Australia was inaugurated at the beginning of December, 1934, the time occupied being about seven days.

The leading role which the Royal Air Force played in the 1939–45 War led to vast developments in aircraft design and propulsion, and these researches have carried over into the development of civil aircraft for passenger and freight services.

Two large subsidised corporations, British European Airways and British Overseas Airways Corporation, have regular services to take passengers and freight to all parts of the world. A number of smaller companies operate regular lines, or charter aircraft outside the services of these two corporations.

The number of passengers and tonnage of freight being sent by air is constantly increasing. Cost of air freight is still high in relation to shipping services, but the smooth journeys, the reduction in handling, the reduced risk of damage and pilferage and the speed of delivery, all help to compensate for the high cost. It is natural that the air freight services creamed off some of the less bulky and higher value goods from the shipping services. With the increases in the skills of packing and handling goods, even heavy and bulky items like machinery are now beginning to travel by air instead of sea, when there is urgency of delivery. For air freighting these things need not be packed in heavy and costly crates, and the saving in weight, space, and packing cost reduces the higher air freight charge

to a point where it can be favourably compared with sea freight cost.

A number of shipping companies, seeing the heavy competition they will face from air transport, have recently acquired financial interests in air services or established their own subsidiary companies to participate in air traffic. It is obvious that quantitatively air traffic cannot compete with shipping for freight carriage, but there is no doubt that its importance will continue to increase and that it is the higher value cargoes which can stand higher transport costs which will continue to be attracted to this medium of transport.

DOCKS.—A dock may be said to form the connecting link between railway and sea traffic, and provides a means of access for individuals and merchandise passing from one place to another. It is the concentration point of land and sea traffic and must, in addition to providing a sufficiency of railway and siding accommodation, afford ample room for the berthing and standing of vessels. The traffic of the present day is so enormous that these functions must be subdivided to meet the requirements of transport.

Besides separate docks having to be allocated to special traffic, other services such as changing from land to sea traffic, and *vice versâ*, have to be performed. The modern dock must also supply storage accommodation for every kind of commodity; e.g. coal, grain, timber, wool, perishables, and general merchandise.

The accommodation for certain perishable traffic must include markets for its sale—subject to discharge from the ship. This is particularly the case with fish, which entails the establishment of ice factories and fish-drying grounds. Grain calls for particular plant, such as elevators, and for specialised treatment during storage. Timber demands vast storage yards, with saw mills in the immediate vicinity; and miles of storage must be provided for coal for shipment. Lastly, passenger traffic requires considerable accommodation, including a hotel, passenger station, and refreshment and waiting rooms. These particular requirements are distinct from those involved in the conduct of ordinary merchandise traffic.

The selection of a site for a dock is governed by engineering requirements, as well as by its proximity to the centres of population which it is intended to serve. Its effective traffic zone by land will depend upon its location, railway access, and freight tariff, coupled with the proximity to, and facilities of, rival ports.

The most important feature to consider in connection with the location of present day docks is the approach to the dock and the depth of the water in the dock. Where possible, the dock must lie alongside a deep water channel, so as to necessitate the minimum amount of dredging, and the depth of water in the dock must be such as to give a draught sufficient for the largest vessel likely to use it. In considering the " lay-out " of the dock, certain factors must be borne in mind, the chief of which are—

(1) *Attention must be paid to the different kinds of traffic with which it is intended to deal.* It is usual to reserve special quaying space or dock accommodation for traffic of various descriptions, but the extent to which this is carried out varies with the size of the dock and the diversity of the traffic dealt in. For instance, general cargoes consisting of ordinary merchandise require particular quayage and equipment; cranes of average capacity are required for conveying the goods from the warehouse to the ship, or from the ship to the wagon. The shipment of coal demands special appliances and storage. Grain, which is solely import, requires housing accommodation and dock space for discharging from the vessel to the warehouse.

Timber requires quayage and must be kept separate from other cargo; whilst fish, owing to particular requirements of the trade, demands accommodation because of its perishable nature. In short, any traffic which attains to such a volume as to be reckoned in shiploads calls for special accommodation.

(2) *The necessity for accommodation for boats awaiting turns at the loading berth.* With regard to the necessity of providing accommodation for boats awaiting their turn to load, the busier the dock, the less the possibility of berthing vessels immediately on arrival. Therefore there must be such central water space to enable boats to obtain quayage space.

(3) *The free and easy passage of boats into and out of the docks.* The constant arrival of vessels renders it essential to have sufficient room to turn and pass along the quays so as to prevent congestion in working.

In order to deal economically with the traffic, it is necessary to utilise part of the dock for the export and part for the import trade. The traffic for shipment enters the reception sidings, where the numbers of the wagons are booked. The wagons then enter the

sorting sidings, where they are arranged by shunting engines according as their contents are intended for shipment direct to the quay sides or to the transit sheds.

RESULTS OF MODERN TRANSPORT.—The great advantage of modern transport is its ability to penetrate inland areas. Before railways were invented, white people did not generally inhabit the interior parts of large continents because of the difficulty of receiving and dispatching goods. This could only be done by native carriers or by rivers. Thus America, Africa, and Australia were inhabited by white people on or near the coasts. When railways came to be built, however, the development of the interior parts became possible. It created new empires with large land masses.

Among the results of the development of modern transport facilities are—

(1) The sale of heavy and bulky commodities in distant markets.

(2) The tendency to break down self-sufficiency and to increase territorial division of labour.

(3) The increased value of Colonial possessions as sources of raw materials.

(4) The introduction of refrigeration, and the conveyance of perishable goods over greater distances.

(5) The exploitation of coal and oil resources.

(6) Increased competition, which in turn has given rise to the formation of pacts and the establishment of combines.

Modern transport provides the conditions for the increased mobility of passengers and of goods, and thus facilitates trade. At the same time the fear of war has created the desire in most countries to safeguard certain essential services by the erection of tariff barriers. Moreover, railways, steamers, and aircraft with their ability to transport human beings and goods on a much larger scale tend to augment the fighting forces and munitions employed in warfare, so that wars are becoming much bigger and more destructive to the nations involved.

TEST PAPER

1. "Transport gives to commodities the utility of being in places where they are required." Discuss this definition, and in the light of your analysis show the influence of efficient transport in a modern community.

2. Enumerate the principal items of development of communication and transport during the past century and remark upon their economic consequences.

3. Enumerate the considerations which govern the classification of goods for the purpose of fixing the rates of most forms of transportation.

4. "Railway rates and charges are not determined by the cost of carrying the goods themselves, for if that were the case, some goods would never enter into Commerce at all." Criticise this.

5. Explain the principle of transport agencies charging "what the traffic will bear," and illustrate some of the effects from the point of view of the trader.

6. Illustrate how the method of packing and the cost of handling goods help to determine the rates of transportation.

7. Agriculturalists in Britain generally complain of unduly high railway rates for agricultural produce, citing as an argument lower rates obtainable on the Continent for similar traffic. Examine the justice of their complaint.

8. Compare the facilities offered by the parcel post with those of the railway.

9. Write short notes upon—

Certificate of Registry;	Net Tonnage; and
Gross Tonnage;	Classification of Ships.

10. What is the object of the Ship's Manifest?

11. Say what you know of the determination of shipping freights?

12. Name some of the chief British Shipping Companies and indicate the sphere of their operations.

13. Enumerate some of the advantages of canals as compared with other modes of transport.

14. Estimate the significance of air transport.

CHAPTER XLVIII

ROAD TRANSPORT

ALTHOUGH the roads represent the oldest artificial transport medium in Great Britain, the great industrial and commercial development which occurred in this country during the nineteenth century was founded upon the railway as a means of transport. The early years of the nineteenth century were marked by a considerable improvement in the science of road engineering under the influence of such pioneers as Telford and Macadam, but after a short period of development the roads lost their importance for industrial purposes until the *motor car* came into general use in the present century. Hence, at the beginning of the century we possessed in this country an intricate road system of indifferent character, with an infinite variety of width and gradient. The development of mechanically propelled vehicles during the first decade of the century brought with it the need for change and improvement, since roads which were eminently suited for use by the slow-moving horse-drawn vehicle were ill adapted to the heavier and faster motor vehicle. Although many improvements in the road network were made, the increase in road transport and the concentration of industry around London and the large conurbations developed more rapidly, and we are now suffering a slow strangulation in road traffic in the large towns because the road-building programme has not kept pace.

GROWTH OF MOTOR TRANSPORT.—The early experiments in the construction of road vehicles all depended on steam as the motive power, but these were unable to compete effectively against the railways and were, moreover, discriminated by the turnpike trusts, which levied prohibitive tolls upon them. The first stage of the modern development came in 1884 when Daimler constructed the light internal combustion engine, and by 1894 the first petrol-driven motor cars were to be seen on the roads. This new mode of transport met with considerable active opposition, and had to overcome a great deal of prejudice in the mind of the public, and it was not until about twenty years later that the commercial possibilities of motor transport were realised. During the First World War extensive use was made of the motor transport vehicle, and after

1918 a period of very rapid development began, with the result that our roads are now predominantly used by motor vehicles. The motor vehicle has transformed the internal transport system of the country, and has completely broken down the former railway monopoly in respect of a wide range of passenger and merchandise traffic. It has given increased mobility to a large section of the population, both for pleasure and for business purposes.

ADVANTAGES OF MOTOR TRANSPORT.—The rapid development of road transport, both in the passenger and merchandise branches, has been largely due to certain substantial advantages which it possesses over its competitors. Prior to the development of effective road competition, the great bulk of the internal transport facilities of this country had been provided by the railways which enjoyed a virtual monopoly. One important effect which has emerged from the new conditions is a more lively sense of the need of improvements in rail transport caused by the creation of competition. The railways have been compelled to take measures to bring about an increase in their working efficiency in order to check the inroads which this new form of transport has made upon their revenue. The benefits to the trading public from this tendency are obvious. The following special advantages may be claimed by road transport over competing forms—

(1) **Flexibility.** Road transport has the great advantage over all other forms that, not being tied to a rail or a waterway, it can more easily give a service from point to point without transhipment or breaking bulk. In the case of both canal and railway the vehicles are confined to a certain route, which involves bringing the goods to a terminal either by the customer or by the transport company. In the case of road transport, however, the vehicle can be brought to the point of shipment of the goods and loaded there and then conveyed direct to the final destination. Merchandise can be packed on a lorry exactly as it is desired to deliver it to the customer, as against the numerous handlings entailed by other forms of transport. Road transport also offers peculiar advantages in the matter of unit consignment, as different parts of the same load can be delivered to various consignees. So far as rail transport is concerned, small unit consignments from the same sender travelling in the same truck will not reap the advantage of the truck-load rate unless the truck is consigned to one individual.

This advantage may be clearly discerned in the case of passenger

transport as well. When a person wishes to travel to a particular destination by rail, he may have to go some little distance to the nearest station, and the probabilities are that when he arrives at his destination he will have to make a similar journey. Omnibus routes, on the other hand, are planned to pass the maximum number of points, and although the passenger may not get a "door to door" service, the probabilities are that he will find that the road conveyance gives a much greater degree of convenience. Moreover, upon the development of a new shopping centre or a new housing estate, road transport routes can be extended or modified without difficulties to meet the changing needs of the community.

(2) **Service in Rural Areas.** Road transport services, in respect of both passengers and freight are more readily adaptable than those of the railways. The capital costs of railway construction are very heavy, so that a considerable volume of traffic is necessary in order to make this expenditure worth while. Now, in many rural areas the amount of traffic is not sufficient to make railway operation an economic proposition, with the result that outlying villages are some distance from the nearest railway station and are put to considerable inconvenience when they wish to use the services of the railway. Again, the services which can be provided by the railways in rural districts are usually of a "skeleton" character. The road transport vehicle can overcome these difficulties to a very great extent, since it can select its route in such a way as to pass through all the main villages in the area which it serves. In addition it can, of course, be employed for the conveyance of goods in small amounts as well as passengers. In connection with the marketing of agricultural produce, the Linlithgow Committee pointed out how the use of the motor lorry has facilitated the speedy collection of milk by creameries over a wide area; again, in certain parts of the country live stock are now regularly conveyed direct to market in specially-equipped motor vehicles, where formerly they were either consigned by rail or driven in on foot. The effect of this development is to extend the producers' markets as well as to effect a reduction in expense.

(3) **Risk of Damage.** One of the most frequent causes of trouble and annoyance to the trading community in the consignment of goods by rail is the necessity for making claims for damage or loss to merchandise. The frequent handling and transhipment, and the

fact that goods of all descriptions have to be dealt with, increase considerably the risk of damage, particularly in the case of perishable or fragile goods. For example, in the case of such a commodity as eggs, complaints of breakages on rail are general, and it is a matter of extreme difficulty to apportion the blame between the consignor and the railway company. Claims for compensation in respect of breakages, however, are seldom recognised by the railway companies, as the complainants can seldom show that they have complied with the requirements in the matter of packing. Much of this difficulty can be avoided by using road transport for easily damageable goods. Transhipments are eliminated and economy can be effected in the packing without exposing the goods to such risk of damage. It has been shown, for example, by dealers in glassware and delicate wireless components, that whilst there were breakages in a large proportion of railway consignments, comparatively little damage occurred among goods sent by road.

(4) **Cost of Service.** It is an undoubted fact that one of the features which have done so much to popularise road transport has been the saving made possible to consignors by reason of road transport rates being relatively lower than those for other means of transit. In considering some of the causes of this difference it may be noted that the road haulier has fewer expensive obligations than the railway undertaking. For instance, in the matter of safety, the signalling and policing of the roads is done for him by the public authorities at the expense of the community, whilst the railways have been compelled by law to build and maintain an extremely costly and elaborate apparatus which is necessary for the safeguarding not only of the public, but also of their employees. For this and similar causes in railway operating costs overhead charges which do not vary in relation to the individual job occupy the chief position. In consequence, the basis of railway charges has been commonly described as "what the traffic will bear," and the resultant figure has not necessarily borne any strict relation to actual cost. In fact, to obtain an accurate unit of cost for railway transport is an almost impossible task. The road haulier, on the other hand, has tended to base his rates on actual cost of operation, a basis which is relatively easy to ascertain on account of the relatively small operating units involved, and the fact that direct cost forms the greater proportion of road operating costs.

(5) Speed of Transit. So far as relatively short distances are concerned, road transport tends to be quicker than rail on account of the delays caused, in the latter case, by terminal services, collection and delivery, and partly by shunting operations. Short-distance traffic is most affected by this factor, since on the long haul the greater speed of the railway counterbalances these delays. The general advantages of prompt deliveries are obvious, particularly in the case of perishable goods, but a substantial advantage of a less evident type is the more rapid circulation of capital previously locked up in stocks of goods in transit. A typical instance may be cited in the tea trade. Before the introduction of road transport tea was delivered from London to Yorkshire by coastwise steamers, and thence by rail to the inland towns, the time taken being about a week. Now the bulk of this traffic is collected one day by motor lorries in London and delivered in Yorkshire the following day.

TYPES OF MOTOR TRANSPORT.—In considering the general economic organisations of the road transport system, we may draw a broad line of distinction between passenger and merchandise transport. Dealing with vehicles in the first class, we have those which are used *privately* and those which are at the disposal of the public and known as *public service vehicles.* The motor vehicles used exclusively for private purposes are private cars and motor cycles, and in recent years, owing to reductions in the cost of production by the application of mass production methods, the popularity of the private car has increased by leaps and bounds. At the present day, indeed, the private car is the most numerous of any class of motor vehicle in Great Britain. It is used extensively both for business and pleasure by large numbers of people, and has done much to increase the mobility of the population and to spread the travel habit. Professional men, commercial travellers, and other business men make considerable use of the private car, since it renders them independent of other forms of transport and gives them added convenience.

The public service vehicle is one which is used for carrying passengers for hire or reward, the operation of which is regulated under the Road Traffic Acts, 1930 and 1934. Under these Acts, two types of vehicle are distinguished, the first of which is the *stage carriage.* This class of vehicle includes those engaged in local passenger services, operating on the basis of a series of stages, and

stopping frequently for the purpose of picking up or setting down passengers. This class of vehicle is engaged mainly on urban and suburban traffic, but it may also connect up near-by towns or a series of villages in a rural area. The second type of vehicle is the *express carriage* which, generally speaking, may be said to be engaged in the conveyance of long distance traffic. In this case stops are made only at certain scheduled points, which are usually at some distance apart. This long-distance road transport is much slower than the railway, but the fare is usually lower and the opportunities of seeing the country are greater for the traveller to whom speed is unimportant.

On the side of goods transport we find a very numerous class of vehicles owned by business houses which employ them exclusively for the purposes of their own business. In much the same category we might place the special vehicles owned by many municipalities for refuse collection, street sweeping, watering, and road construction. On the other side, there is the *haulage contractor*, who is prepared to contract for the conveyance of goods although he has not the obligations of a common carrier. Intermediate between the two is the firm which uses its vehicles mainly for the delivery of its own goods, but is prepared in slack periods to take work under contract for outside firms. In this haulage-contracting business a general line of distinction may be drawn between the long-distance and the short-distance haulier. A long-distance haulier was defined in the Final Report of the Royal Commission on Transport as "a person, firm, or company who is the owner of mechanically-propelled vehicles of any weight, who for his own profit utilises those vehicles for the transport of goods by road belonging to other persons for distances in excess of thirty miles from the base from which such vehicles operate." This distance of thirty miles is more or less arbitrarily chosen, but for distances between thirty and fifty miles it is possible for the owner of a lorry to make a journey from his point of loading and back in a single day, making due allowance for delays at either end In such circumstances no special expenses have to be met for board and lodging of the driver or garage expenses for the lorry, and rates can be kept down to a very low level. Over this limit, however, where a lorry may be away for two or more days, some higher degree of organisation is called for. In the case of the short-distance haulier it is possible to make the return journey

empty without suffering any serious loss, but to do so over a long distance must either result in loss to the haulier or cause a substantial rise in freight rates.

The Public Service Vehicle. The use of these vehicles, which are engaged in the conveyance of passengers, is governed by the provisions of the Road Traffic Act, This Act contains comprehensive regulations governing the licensing and control of vehicles

MOTOR TRANSPORT

- **Passenger Services**
  - **Public Service Vehicles**
    - **(1) Stage Carriages**
    - **(2) Express Carriages**
  - **Private Vehicles**
    - **(1) Private Cars**
    - **(2) Motor Cycles**
- **Merchandise Services**
  - **Haulage Contractors**
    - **(1) Local Carriers**
    - **(2) Long-distance Hauliers**
    - **(3) Clearing Houses**
  - **Private Vehicles**
    - **(1) Private Hauliers**
    - **(2) Limited Hauliers**

used for the conveyance of passengers. Under the terms of the Act, England and Wales are divided up into eleven traffic areas, each under the jurisdiction of three Traffic Commissioners. These Commissioners are entrusted *inter alia* with the following duties—

(*a*) The granting of public service vehicle licences without which no person may allow a vehicle to be employed on the road in that capacity. This licence will not be granted unless the Commissioners are satisfied that the vehicle is of suitable construction and fitness.

(*b*) The granting of road service licences to operators and attaching suitable conditions to their issue. The decision of the Commissioners as to the granting of a licence will be influenced by such factors as the suitability of the route on which it is proposed to operate, the facilities already in existence, the desirability of the service to the public, and the needs of the traffic area as a whole. It is the aim of the Commissioners to eliminate unnecessary and unremunerative services, and to aim at the co-ordination of all forms of passenger transport, including transport by rail.

(*c*) The granting of licences to drive or to act as a conductor of a public service vehicle. Before this licence will be granted a driver

must produce evidence that he is over 21 years of age and over 18 years of age in the case of a conductor. In either case the applicant must give evidence of his ability to read and write, and produce certificates as to character and physical fitness.

One of the principal tasks of the area Traffic Commissioners contemplated by the Road Traffic Act, was the elimination of unnecessary services with the object of eventually establishing a "control monopoly" of road passenger transport. As a result of the efforts of the Commissioners a high degree of stability has now been reached in the omnibus and motor-coach industry. The passenger transport industry is now for the greater part under the financial control of a small number of powerful companies, although the various units which comprise it still retain their former names and preserve an outward appearance of independence.

The Road Traffic Act, 1930, imposed strict regulations with regard to maximum speeds and hours of work for the whole industry. Many of these regulations have been evaded, especially in the road haulage industry, on account of the reluctance of local authorities to add to the many existing duties of the police force. In particular the provisions of the Act with regard to hours of driving has never been properly observed in the goods transport industry. An attempt was made under the Road and Railway Traffic Act, 1933, and also under the Road Traffic Act, 1934, to tighten up these requirements by imposing severe penalties for their infringement and by providing machinery for inspection and control.

Private Fleets of Goods Vehicles. Of all the motor vehicles engaged in the transport of goods in this country it has been estimated that over 70 per cent are owned and operated by manufacturers and traders for the conveyance of their own products. Under the provisions of the Road and Rail Traffic Act, the owners of such vehicles are compelled to take out a road service licence—known as a "C" licence—in respect of them. This licence is granted solely upon an undertaking to comply with conditions regarding fitness of the service, speed, and weight limits, hours of driving, and similar matters, and there is no attempt to limit the numbers of such vehicles. As already pointed out, some traders possess their own vehicles which they use primarily for the carriage of their own goods, but are occasionally prepared to carry the goods of other persons. These are known as "limited carriers," and the Act lays

down that such operators must work under licence—known as a "B" licence—and are subject to such restrictions as the Traffic Commissioners may see fit to impose. These restrictions include the following conditions—

(*a*) That a vehicle shall be used only in a specified locality.

(*b*) That only certain classes of goods shall be carried.

(*c*) Any other conditions which the commissioners may think fit to impose in the public interest and with a view to preventing uneconomic competition.

In deciding whether a firm shall operate its own fleet of vehicles or hire transport facilities from outside, consideration has to be given to a number of factors. In the first place it must be decided whether the volume of traffic handled is sufficiently large and whether it is of a regular or of a seasonal nature. It is futile to place vehicles on the road if they cannot be employed on a paying basis of operation, that is unless some powerful indirect advantage can be gained from them. Again, before the investment of capital in such a private fleet is made, a careful scrutiny should be made of the maker's statistics of operating costs, including wages, tax, insurance, depreciation, running costs, and general upkeep, and the unit cost of operation arrived at. This should then be compared with present costs of transport. Finally, a suitable system of organisation must be devised for ensuring proper maintenance and repair, and for keeping a proper record of the movements and work of all vehicles and their drivers.

The possession by a trader of his own fleet of vehicles confers upon him considerable advantages if these are not outweighed by considerations of cost. By owning his own means of transport it is possible for a trader to arrange his deliveries to suit his own convenience or that of his customers—a matter which cannot always be done when he is dependent upon outside firms for transport facilities. Moreover, by keeping the transport of goods under his own control he is enabled to check losses arising from damage or pilferage in course of transit. The driver of a lorry is made responsible for the safe delivery of all goods entrusted to his charge and, in the event of complaints being made by customers, it is possible to assign responsibility for the matter. In any case, on account of the greater personal interest, goods are likely to be more carefully handled by a trader's own employee than by an independent carrier.

Where goods are delivered in the trader's own vehicles, packing expenses can be reduced to a minimum. Finally, a private fleet of motor vehicles can be of considerable advertising value to a firm, and there has been a tendency of recent years for firms to order vehicles of special design in order to advertise their goods.

The Haulage Contractor. Under this heading we may include all those organisations whose business it is to carry goods for hire on behalf of the trading public. It is in this section of the motor transport industry that the lowest degree of organisation and the worst working conditions prevail. The Final Report of the Royal Commission on Transport divided road hauliers into three classes, viz.—

(*a*) Well-organised companies owning fleets of vehicles.
(*b*) Owner-drivers or individuals operating two or three vehicles.
(*c*) Clearing houses.

The third of these classes is dealt with later, and for the moment we shall concern ourselves with the first two. The owner-driver is generally a new-comer to the trade and has little business experience, little knowledge of the cost of running a lorry for a series of years, and no appreciable organisation for obtaining traffic. On account of his lack of business capacity and ignorance of costs of operation, he can readily be induced to accept loads at rates which are uneconomic. Moreover, though bankruptcies are frequent amongst this class of operator, entry to the industry is so easy that their places are quickly taken and destructive competition goes on unchecked. A person wishing to enter this trade can purchase a second-hand lorry cheaply or can buy a new one on the instalment system, so that his capital outlay is reduced to a minimum. Amongst this class of operator rates of wages and conditions are poor in the extreme.

An attempt was made under the *Road and Rail Traffic Act*, 1933, to deal with this overcrowding and unbridled competition in the haulage industry. Under the terms of this Act all public carriers must obtain from the Traffic Commissioners what is termed an "A" licence. A haulier already in business will receive such a licence which is available for two years after the commencement of the operation of the Act. Apart from this exception, however, the licensing authority has discretion to grant licences, and in doing so must take into account objections made by persons already

providing facilities for the carriage of goods—whether by road, rail, or otherwise—in the same area as the applicant, together with the general traffic requirements of the area. Further, all licences granted under the Act, including the "B" and "C" licences already mentioned in connection with limited and private carriers, are given subject to the following conditions—

(*a*) The vehicle shall be maintained in a fit and serviceable condition.

(*b*) The appropriate limits of weight and speed shall be complied with.

(*c*) Drivers shall comply with the requirements of the Road Traffic Act, 1930, regarding the hours that they may remain on duty.

(*d*) Records of hours and journeys shall be kept, except where the nature of the business makes it impracticable.

It was hoped as a result of this measure to bring the road-haulage industry to a condition of organisation similar to that prevailing in road passenger transport. Side by side with the owner-driver, well-organised road-haulage companies have always existed, performing service of unquestionable value to the trading public. Their stability has, however, constantly been threatened by the actions of the small owner-driver who has reduced rates to uneconomic levels. It is now possible, at the discretion of the Traffic Commissioners, to refuse licences to new hauliers where the traffic facilities already available can be shown to be sufficient for the needs of the trading community. In this way, encouragement and a measure of protection is given to the well-organised company employing an economic scale of rates and charges as against the rate-cutting activities of the small owner-driver, and it is possible to give more regular and efficient service to customers and to draw up a more stable schedule of rates and charges.

ROAD CLEARING HOUSES.—We have seen that the road-haulage industry is mainly in the hands of a very large number of small operators, whose facilities for obtaining traffic are necessarily very limited. There exists a definite gap between those who have road transport facilities available for hire and those having goods awaiting transport. This gap is filled by the institution of the *Road Clearing House*, the purpose of which is to act as a link between the trader who wishes his goods carried and the haulier who carries the goods, and in particular to save the haulier the time and trouble

of canvassing for return loads. The aim of the road haulier should be to attain the maximum loaded mileage for his vehicles, since his lorries are earning revenue only when they are under load. If he is compelled to make frequent return journeys without a full load, or without any load at all, his rates must be increased accordingly, and this may result in a loss of traffic if his competitors have better facilities for the collection of return loads.

A clearing house has been defined as embracing "all companies, firms, and persons contracting with a trader for the cartage of freight by road motor haulage and sub-contracting for a minimum of 75 per cent of its road freight turnover per annum with a third party for the actual cartage thereof." The first genuine clearing house was founded in Birmingham by the Ministry of Munitions in 1916, when the limited facilities available for transport made the full utilisation of vehicles an urgent necessity. The success of this clearing house was followed by the establishment of similar institutions under the control of chambers of commerce throughout the country, thereby providing a network of clearing houses at such centres as Manchester, Leeds, Huddersfield, and Halifax. When these were closed down at the end of the First World War, they were followed in many cases by the foundation of clearing houses under private control, though many chambers of commerce still continue their efforts in this direction.

NATIONALISATION OF ROAD TRANSPORT.—The Transport Act, 1947, made provision for the compulsory acquisition of certain long-distance road undertakings by the British Transport Commission. "Long distance" is defined as a route mileage of forty or more miles, necessitating a journey beyond a twenty-five mile radius from the operating base. It was estimated that the Commission would acquire some 34,000 lorries, 11,000 of which would be taken over from the railway companies. About 1,000,000 commercial vehicles operating under "A" and "B" licences and 380,000 commerical vehicles operating under "C" licences would not be acquired by the Commission.

In 1953 the Conservative Government repealed the application of the Transport Acts to road transport, and the road undertakings taken over were sold back to private concerns. This was done under considerable difficulty because of the fear that a change of government might bring re-nationalisation of these undertakings.

TEST PAPER

1. Account for the revolution in road transport which has taken place during the first half of the century.

2. Consider the special advantages of motor transport over competing forms under the headings—

(*a*) Flexibility, (*b*) Risk of damage, (*c*) Cost of service, (*d*) Speed of transit.

3. Explain clearly, by means of the diagram on page 506, the main types of motor transport engaged in the conveyance of passengers and merchandise.

4. Explain the functions of a Road Clearing House.

5. "The Road and Rail Traffic Act, 1933, constituted an admission that the competition between road carriers and railways in Great Britain was on an unequitable basis but a refusal to adopt an equitable basis." Support or rebut this statement.

6. "In a great city the solution of the passenger traffic problem can only be found by the co-operation of many forms of transport, and each of these has its own merits and requirements." Examine this statement and indicate the traffic conditions best suited to the various forms of urban transport.

7. Discuss the advantages to a large business house of having its own fleet of motor vehicles instead of making delivery by rail or by a road haulage contractor.

8. "Railway rates are based on the principle of what the traffic will bear, whilst rates for road transport are based on cost."

Explain this statement and discuss the reason for the difference.

9. In what ways would traders and the travelling public benefit from the co-ordination of road and rail transport.

CHAPTER XLIX

Railway Transport

DEVELOPMENT OF THE RAILWAY.—The railway was the pioneer of modern mechanical transport, and was responsible for the greatest revolution in communications and the transport of goods that has ever taken place in the history of the world. Indeed, it may be said that up to the time of the First World War, so far as land transport was concerned, the railway held an almost unbroken monopoly. Since the War, it is true, this monopoly has come under strong challenge in consequence of the development of motor road transport, which has created many disturbing problems in this and in other countries. Yet, despite this competition from a rival mode of transport, the railway still retains its essential importance in the economic life of every country, and road transport can never hope to supersede it. The development of great Continental areas—Africa, Australia, or the U.S.A.—has depended upon the construction of a railway, and the economic life of vast regions within those areas is pre-conditioned by its existence. Thus the great wheat industry of Canada was created by the railway and could not continue in existence on its present scale without it. In India the railway has enabled the Government to cope with the disaster of famine in districts which, before the advent of railways, were too distant from the centres of distribution to be helped effectively; they have stimulated economic development by enabling the products of the interior to be brought to the coast for export; they are also of considerable strategic value to the authorities.

Even in our own country, where the competition of the road is far more obvious and effective than in many other countries, railways hold their place, and, as far as can be seen, are indispensable for many purposes. Indeed, the railways of the United Kingdom are a national necessity, not merely because they are the cheapest and quickest method of conveying the greater part of the country's merchandise over long distances, but also because for the heavier types of commodities they are still the only practicable form of conveyance. The coal trade and most of the other "heavy" industries are for all practical purposes dependent on the railways, since

conveyance of their products by road is impracticable except in small quantities and for short distances. Furthermore, the railway authority has the inestimable advantage of large and unimpeded arteries of communication running right into the centres of our large cities. In short, the public utility of railways is far from exhausted, and no alternative means of transport now in sight seems likely to make the railway useless.

The railways, in common with many other British industries, suffer from the fact that they were pioneers. Early railway promotions were carried out in an atmosphere of ignorance and prejudice which has left a lasting mark on our railway structure. Frequently land had to be purchased at exorbitant prices from land owners who wished to compensate themselves for the injury which they imagined their property would suffer. The opposition of town corporations often resulted in long and expensive deviations of track. Vested interests, such as the canal companies, opposed the promotion of railway bills in Parliament with the object of getting "bought out" of a business which they could see was doomed once the railway was established. All these things inflated capital expenditure, with the result that the capital costs per track mile are £56,000 in the United Kingdom, as compared with £30,000 for France, and £16,000 for the U.S.A. Moreover, the interest charges on track construction costs alone are calculated by the railways themselves to be not less than £36,000,000 a year. To make matters worse, Parliament, in fear of a railway monopoly of inland transport, deliberately fostered competition by authorising a large number of small separate undertakings. All these things have created difficulties which have persisted to the present day, and are responsible in no small measure for the economic troubles of the railways at the present day.

STATUTORY CONTROL OF THE RAILWAYS.—From their inception, the railways have been subject to an increasing degree of Government control designed to protect the public against danger to life and limb and against undue exploitation in the charges. The extent of this interference may be gathered from the fact that during the past hundred years there have been about 200 public Acts dealing with the number and regulation of railways. During the experimental stage of their development, there was relatively little Parliamentary interference, but as their importance became

realised, regulating Acts became increasingly frequent. State regulation in Great Britain has fallen under the following main headings—

(1) The construction and equipment of the railways.

(2) Safety of passengers and of employees.

(3) Securing that reasonable facilities shall be given and that there shall be no undue preference.

(4) Regulations as to rates, fares, and other charges.

(5) The rendering of financial and statistical returns.

The motives underlying this mass of regulation have naturally been of a varied character, but the following considerations have exerted a great deal of influence—

(1) **Nature of Railway Construction.** Railways fall within that group of undertakings which is commonly described as providing public utility services, and for the accomplishment of their objects they required special powers. Thus, in order to complete a track, compulsory powers had to be taken for the purchase of land, highways had to be bridged, and other rights of property interfered with. For this purpose, special authority was required from the State, and this authority could not be given without a preliminary investigation to ascertain whether it was warranted. On this account, British railways were Parliamentary companies, each deriving its authority from a special Act of Parliament, and not being incorporated in the usual way under the Companies Act. Further, the companies were bound by any special legislation governing construction, such as the Railway Gauge Act, 1846, which specifies the standard gauge of 4 ft. 8½ in.

(2) **Special Safety Regulations.** The subject of safety on railways is admittedly very important, and the law provides for elaborate precautions to be taken. It is of public interest that the large number of persons using the railways shall do so with a minimum of risk. Thus the law required every railway company to give notice to the Ministry of Transport of its intention to open any new section of line for passenger traffic, and placed upon that department the duty of inspecting the line before it was opened. Again, railway companies were required to report to the Minister all accidents which caused, or might have caused, loss of life or personal injury. The safety of railway employees, as distinct from passengers, is also

a subject which has been dealt with at length by legislation, whilst the Minister is empowered to make rules for the purpose of removing or reducing the dangers incidental to railway service.

(3) Danger of Discrimination. A further motive for regulation was created by a fear of abuse of monopoly which the railways held in the nineteenth century. It was felt that they might abuse their position by withholding reasonable facilities for traffic or by discriminating between different members of the trading public. Accordingly, under the terms of the Railway and Canal Traffic Act, 1854, the companies were bound to "afford all reasonable facilities for the receiving and delivering of traffic upon and from the several railways and canals belonging to, or worked by, such companies respectively, and for the return of carriages, trucks, boats, and other vehicles, and no such company shall make or give any undue or unreasonable preference to, or in favour of, any description of traffic, in any respect whatsoever, nor shall any such company subject any particular person or company, or any particular description of traffic, to any undue or unreasonable prejudice or disadvantage in any respect whatsoever." No definition of "undue preference" has been formulated by Parliament, and the Railway and Canal Commissioners, with whom lay the jurisdiction to determine complaints under these provisions, were more or less free to attach such meaning to the term as appeared to them to be proper in a particular case.

(4) Danger of Excessive Charges. The nineteenth century railway monopoly created a further fear less the railways should levy excessive charges. Hence Parliament exercised a continual influence over the rates which the companies were authorised to charge, the general policy being to prescribe maximum charges which could not legally be exceeded, and thus to prevent railway rates from becoming excessive. The charging powers of the various railways were revised under the Railway and Canal Traffic Act, 1888, when uniformity in regard to all the railways was introduced. Under the same Act provisions were inserted whereby the charges for carriage varied according to whether the company or the trader provided the wagon; in the latter case a rebate was allowed from the charge. These charges covered various kinds of services, including collection and delivery, terminal charges and conveyance charges. Charge for detention or demurrage of vehicles was also another authorised charge.

THE RAILWAYS ACT, 1921.—When war broke out in 1914 the Government took over the railways and kept them under its control until 1921, guaranteeing to them the net revenue they had had in 1913. But after the War it was obvious that the position required special treatment, and the railways were, in effect, reconstructed under the Railways Act, 1921. The opportunity was taken to re-adjust the relations of the railways to the State, to their employees and customers, and to each other. It was hoped by the Government that the measure would enable the railway companies to bring about economies long desired by the directors and management, that it would assure to the users reasonable facilities at reasonable rates, and would by the provision of adequate and effective cost and operating statistics, enable the proprietors to familiarise themselves with the management of their property. The main provisions of the Act may be classified under the following heads, namely—

(1) **Grouping.** The first part of the Act provided for the grouping into four groups of about 120 separate railway companies; that is to say, practically every railway company of importance in Great Britain. Broadly speaking, each group had a monopoly in its own area, but there was competition where the areas touched or where they overlapped. This step, it was claimed, nearly carried to its logical conclusion the practice of railways in the past, the object being operating economy and administrative efficiency. It was expected that very considerable economies of operation would result, though estimates of their amount varied widely.

(2) **Compensation.** One of the earliest sections of the Act dealt with the settlement of claims in respect of the Government possession of the railways during the 1914–18 War. This was effected by the payment of a sum of £60,000,000 as a full discharge of all claims except those arising out of certain agreements previously made by the Government with the companies.

(3) **Charging Powers.** The Act completely abolished the system of regulating charges previously enforced, and in the place of it substituted an entirely new method. A court known as the Railway Rates Tribunal was set up with very extensive powers, covering every aspect of railway charges. This body was empowered to fix rates, fares, and other charges so that a standard revenue would be earned by each of the groups. The method of arriving at this revenue was carefully defined, and provision was made for its annual

revision, but no guarantee was given that this revenue would be realised. In fact, the new system came into operation at the beginning of 1928, but from that date not one of the four amalgamated companies realised its standard revenue.

(4) **Relations to Employees.** In order to improve the relations between the companies and their employees, the Act contained elaborate provisions relating to the wages and conditions of service, and provided for a system of conciliation councils with functions not dissimilar to those of the Whitley Councils established in other industries after the War. These bodies were consultative only, and their decisions were not usually enforceable.

(5) **Accounts and Statistics.** Accounts had to be prepared on lines indicated by the Minister of Transport, whilst certain statistics and returns had also to be made.

Unfortunately the introduction of the Railways Act, 1921, coincided with the commencement of a depression which continued until the outbreak of war in 1939. During the Second World War the railways were again controlled by the Government. Another serious matter for the railways was the growth in the popularity of road traffic after 1918. People nowadays have their own cars and their own vans so that the railways lose a considerable amount of traffic in passengers and goods. There is also the competition of road transport companies.

NATIONALISATION OF THE RAILWAYS.—A Report presented to the Minister of Transport by the Transport Advisory Council in April, 1939, dealt with the railway companies' claim to what they had epitomised as "a square deal." The Report insisted on the desirability, and even the urgency, of a proper co-ordination of all forms of transport for the sake of both national economy and national efficiency. In the main, the claims of the railway companies for release from unfair and obsolete restrictions were allowed. The Council recommended the repeal of the provisions relating to the classification of merchandise and the fixing of standard charges. This relaxation amounted to putting the railways on equal terms in their competition with road transport. At the same time, both industries and individual traders were confirmed in their right of appeal to the Railway Rates Tribunal for a reduction of any charge. It was necessary to ensure that the protection thus given to the individual trader would be sufficient for his needs. The Government

accepted the Report, but the matter had to be postponed on the outbreak of the Second World War. During the war the Government once again controlled the railways and paid a rental of about £43,500,000 to the companies.

After the war the Government decided to nationalise the transport industry and under the Transport Act, a British Transport Commission was established consisting of a chairman and from four to eight other members appointed by the Ministry of Transport. The Commission was assisted by five Executives, viz. the Railway Executive, the Docks and Inland Waterways Executive, the Road Transport Executive, the London Transport Executive, and the Hotels Executive, but the Transport Act, 1953, provided for the abolition of these Executives except the London Transport Executive.

For operational purposes the railways have been divided into six regions. The Railway Rates Tribunal has been renamed the Transport Tribunal and exercises the same jurisdiction over transport matters as did the Railway and Canal Commission.

THE RAILWAYS IN THE SERVICE OF THE TRADER.—One of the accusations most frequently levelled against the British railway system has been that of undue conservatism—a failure to make adequate provision for the needs of the trading community. So long as the railways had a virtual monopoly of inland transport, the spur of competition was lacking as a stimulus to greater efficiency. In the inter-war years, however, there were ample signs of a new spirit of enterprise. Thus, the London Midland and Scottish Company set up a special Sales Department—an entirely new departure in railway work—devoting its whole time to the study of sales methods in industry generally and of how they could be applied to the railways. Again, the London and North Eastern Railway Company developed a system of travelling motor representatives in order to obtain better liaison and contact with customers with whom contact was difficult previously. Each representative resided in his own division, where he was available at any time to assist the interests of the company and to help to remove misunderstandings or prejudices regarding railway transport.

The following are some of the special services which the railways perform for the trader—

(1) **Warehousing Goods.** This function is of considerable importance

to the trading community, and the railway undertaking is the largest warehousing concern in the country. The change in trading habits which has taken place in the last few years has greatly increased the demands made upon the railways for storage. The retailer of to-day carries on his business with a minimum of stock relying on speedy modern transport service to make up his stocks. Hence it has become of greater importance to manufacturers that they should be able to execute orders with a minimum of delay, and there has arisen throughout the country a demand for warehouse space for the setting up of branch depots easy of access to customers in the surrounding district. Considerable expense has been incurred in order to adapt these facilities to the needs of trade. Thus at Soho, near Birmingham, in a district which deals largely with non-ferrous metals, a warehouse has been erected for their storage. It is a peculiarity of these metals that their qualities are judged best by daylight, and the warehouse has been fitted with skylights which give the maximum of natural light, while daylight lamps have been provided for inspection when natural light fails. The provision of apparatus for stacking reels of paper, of refrigerators for perishable goods, and of wireless aerials for the testing of wireless sets in warehouses are examples of the steps which have been taken by the railways to meet the needs of those who use their warehouses.

(2) **Registered Transit.** A system of registered transit of merchandise and live stock by goods train, known as the Green Arrow System, was introduced by the railway companies. Besides providing the quickest possible service for goods it enables the sender to know at the time of dispatch the date and time at which the consignment will be delivered. This system is similar to the registered post, for immediately a consignment is registered it is brought within a specialised control system. The goods bear a distinctive "Green Arrow" label, which ensures prompt handling. The registration fee is half-a-crown for each consignment, which may consist of a single package or a train-load. This guaranteed delivery system has worked well, for traders in many cases willingly bear the additional cost to ensure delivery by a specified time, as in the case of export by a specified steamer.

(3) **Freight Train Service.** As already indicated, the disinclination on the part of the trading public to tie up capital in large stock has led to a demand for greater railway facilities and quicker journeys

in transport generally. The speed of freight transport has been substantially increased of recent years by the acceleration of goods trains. Moreover, goods depots are now much better equipped than they were a few years ago, while improved marshalling yards and better transhipment arrangements have greatly reduced delays in transit, especially on cross-country journeys. Collection and deliveries are better, and for fast freight traffic there are few important industrial centres between which the Transport Commission cannot now guarantee delivery on the day following the receipt of the consignment. Another development has been the issue of freight time-tables, which indicate the latest time for the acceptance of goods and the time at which delivery may be expected.

(4) **Container Transport.** Another method of reducing both the time and cost of transportation which was introduced with considerable success by the railway companies, is the device of the container. This, in effect, is the demountable body of a railway truck or road motor, which being a separate unit from the chassis, has the advantage that it can travel both by rail and road. Goods can be loaded in containers by the sender's experts on his own premises, a minimum of packing being used. In some cases packing can be dispensed with, thereby resulting in an economy of time and material, as well as a saving of freight charges. Containers are available for the conveyance of all descriptions of merchandise, at special tariffs, but the weight of the container is not charged for in either direction. Again, the advantages for international traffic are obvious; not only can goods be consigned direct to a customer, thus avoiding difficult and expensive transhipments, but, given adequate organisation, customs control could be simplified by sealing the container at any point, thus ensuring that no change is made in the contents en route. Furthermore, since the containers are constructed in units smaller than railway vans, they can be used with success by customers who cannot take whole van loads. All these advantages are especially important in the long-distance shipment of perishables, many categories of which cannot stand handling or disturbance *en route*. Among the traffics for which the container has already become popular are furniture, confectionery, flowers, biscuits, electrical machinery, and meat.

(5) **Rail-head Deliveries.** Another valuable service has been the institution of rail-head delivery by which manufacturers or wholesale

firms have been accommodated with warehousing facilities at convenient rail-head depots, and from these depots delivery of goods can be made to retailers in the district by lorries. Under this system, goods can be sent in the most economical manner in full truckloads by express freight trains from factories or ports of importation, to be warehoused at the rail-head. Distributors are thus provided with a rail base from which dispatches for a particular area can be made. Amongst the advantages claimed for the system is that of speedy delivery, since retailers are enabled to receive consignments on the day after dispatch. By virtue of this short-period transit, these retailers are relieved of having to maintain large stocks of goods. Again, bulk loading and rail-head delivery mean less handling and the elimination of disturbance to fragile packages. The service does not end here, however, for in the case of a firm whose traffic is sufficient for the full occupation of a road van, the vehicle may bear the firm's own name and style. Firms which deal with numerous commodities obtained from different sources are offered special facilities for assembling their consignments at the rail-head. The railway will allot warehouse accommodation on a moderate rental basis, and will provide clerical services if required. Railway employees are prepared to perform a variety of services in this connection, such as the preparation and regular rendering of stock returns, labelling of goods, and the extraction of samples.

(6) **Miscellaneous Services.** In addition to the foregoing, the railways have, in recent years, shown themselves willing to undertake a variety of services on behalf of the business community. Thus, there have been great developments in the handling of exceptional loads, and there is now much more co-operation between the railways and the manufacturers of heavy machinery. Manufacturers can now obtain full particulars and diagrams of the heavy freight vehicles which the Transport Commission has constructed for the transport of loads of unusual size and weight. Another service provided is the mobile warehouses. These are intended for manufacturers and traders who are engaged upon intensive short sales campaigns in particular areas and desire to hold stocks in those areas from which they can draw supplies at short notice. For this purpose parcels vans with storage capacity of approximately 25 sq. yd. have been converted into mobile warehouses suitable for the storage of commodities of all kinds. It was stated a short time after this service

had been inaugurated that a number of firms had decided to occupy permanent warehouses, since the trade developed in this way justified the expenditure. Again, in 1933 the Great Western Railway Company provided a special train to act as a show room during a three months' tour of the country. This train, fitted up by a private firm to exhibit their goods, was accommodated at stations or in goods yards, where it was open to inspection by the firm's customers.

RAILWAY RATES.—The Railways Act, 1921, provided, among other things, for an amalgamation and absorption scheme, with a view to efficient and economical working. The railways were grouped in one of the four groups: Great Western; Southern; London Midland and Scottish; and the London and North Eastern.

The Act also provided for the setting up of a new tribunal called the Railway Rates Tribunal.[1] To this committee almost all the powers of the Railway and Canal Commission Act, 1888, and many new powers were entrusted, its most important function being the settlement of the schedules and charges of the amalgamated companies. The tribunal consisted of three permanent members—one person of legal experience, who was chairman; one person of railway experience, and one of commercial experience. There were also two panels of additional members—one panel consisting of twenty-two persons representing trading interests, twelve representing labour and railway passengers, and two representing agriculture; the other panel consisting of twelve representatives of railway interests. Provision was made for the re-classification and rating of merchandise and the various companies were required to submit a schedule of proposed rates for the consideration of the Rates Tribunal, who, after careful examination, were to fix the charges and to appoint a date for them to come into operation.

SCHEDULES OF RATES AND CHARGES.—The duty of determining the Rates and Charges to be made for the conveyance of goods in the various classes was undertaken by the Railway Rates Tribunal, which endeavoured to fix the amounts at such a level as would yield each group railway a total annual net revenue equivalent, with adjustment in respect of new capital, to the aggregate net revenues of its component railways in 1913. The task of settling this standard revenue was one of great delicacy, but was completed in July, 1927, when the new rates were sanctioned by the Tribunal

[1] Since nationalisation known as the Transport Tribunal.

and became operative on 1st Jan., 1928. Standardized Schedules of charges for each of the four railway companies were drawn up for—

(1) Goods and minerals, except coal, coke, and patent fuel by merchandise train.

(2) Coal, coke, and patent fuel by merchandise train in owner's wagons.

(3) Returned empties by merchandise train.

(4) Rolling stock by merchandise train.

(5) Animals by merchandise train.

(6) Perishable merchandise by passenger train.

(7) Small parcels by merchandise train.

(8) Passengers.

The railways retained the power, under carefully guarded conditions, of making new exceptional rates—a provision which gives them some degree of the elasticity essential if they are to conduct their business on commercial lines.

GOODS AND MINERALS.—This is the most important group, since it includes the bulk of commodities consigned and received by British traders. It is subdivided into twenty-one classes. No. 1 is the lowest class, and applies to the roughest and cheapest goods; whilst No. 21 applies to the most valuable.

Examples of the commodities included under these different classes are as follows—

Class 1. Cinders and ashes for road repairs, iron ore, limestones in bulk.
„ 2. Sand in bulk, bricks, gravel stone (undressed).
„ 3. Ammoniacal liquor, lime (in bulk).
„ 4. Salt rock, creosote.
„ 5. Pig iron, common clay, manure.
„ 6. Ground slate, coal tar pitch, china clay.
„ 7. Pit props, iron and steel plates, plaster.
„ 8. Wood pulp, wire, petroleum pitch, and grain.
„ 9. Marble, fuller's earth.
„ 10. Hay and straw, tin, nickel, and sawdust.
„ 11. Granite, sheet lead, tallow, and sugar.
„ 12. Brass, machinery.
„ 13. Mustard seeds, raw cotton, oils.
„ 14. Lead, brass tubes.
„ 15. Lard and lard substitutes, sage, cotton yarns.
„ 16. Fish, paper serviettes, bulbs.
„ 17. India-rubber, tomatoes in baskets with paper covers.
„ 18. Boot laces, dry yeast, tea, silver.
„ 19. Dead rabbits, razor strops, cotton lace, wine in hampers.
„ 20. Perfumery, live rabbits, pianos and scientific instruments.
„ 21. Liquid gold, gold articles.

A complete list of these goods is given in the *General Railway Classification of Goods by Merchandise Trains.*

The standard rates for conveyance as well as the standard terminals are now uniform throughout the whole country, and are common to all Regions. In rating there are two main factors to be considered—the type of traffic and the distance. As regards the nature of the goods those that are costly, or easily damaged or lost, are charged at a higher rate to compensate for the extra risk and for the extra care that must be expended upon them. Further, as between goods of higher and lower values, the rule applied is " to charge what the traffic will bear." This means that a fairly high rate charged for the carriage of valuable goods causes little proportionate increase in their cost to the consumer, whereas the same rate applied to goods of low value would render the price prohibitive. As regards the distance, the principle of the "tapering " rate has been adopted. Thus a certain charge is made for the first twenty miles, a reduced charge for the next thirty miles, a further reduced charge for the next fifty miles, and a still further reduction for the remainder of the distance, so that the charge per mile decreases as the distance increases.

Except otherwise provided for in the classification, the minimum weights which can be conveyed at the standard rates are 6 tons for classes 1 to 6 ; 4 tons for classes 7 to 9 ; 2 tons for classes 10 to 11 ; for the remaining classes there is no minimum. Where less than the stipulated minimum is consigned goods are charged at a higher rate.

Station Terminals. This charge on this account is mainly for the rent of the station ; the siding accommodation ; the warehouse accommodation, where the goods are loaded and unloaded. It also covers the shunting work, the placing of wagons into position in loading and unloading.

Service Terminals. This group includes loading and unloading, covering and uncovering ; and the two last mentioned include not only the work involved, but also the use of the sheet.

Both these charges vary from one category to another, increasing with the more valuable goods.

Other Services which the Railways may charge for, and for which they are restricted to a reasonable sum, are—

(1) *The services rendered by the railways at, or in connection*

with, the private sidings. If the railways are to be allowed to charge undefined charges for services rendered at a private siding, that implies that other charges shall not be made. No trader can claim to do the work in connection with his goods if his consignment is mixed with other goods in the wagon. Otherwise, the trader can claim the right to do the terminal services, carry them out with his own servants, and in that case the railway may not charge for them.

(2) *The collection and delivery of merchandise outside the terminal station* (i.e. the cartage). It is the usual practice of most railways to include in the ordinary class rates the services of collection and delivery at all places where they undertake such work, so that in all the ordinary class rates — where railways do the work—there are certain rates for cartage which are not subject to statutory maxima, except that they "shall be reasonable"; where the trader is allowed to do the carting himself, he is entitled to a rebate and the removal of the charge for cartage.

(3) *Weighing.* It might be argued that the traffic would (in any case) have to be weighed, but the trader is responsible for the weighing of the traffic which he tenders to the railway authorities. If the trader requires to know the weight, then the railway authorities are entitled to charge him for the service—otherwise they are not bound to tell him. In the case of small consignments, the railways, as a rule, enter all weights and do not require the traders to declare them; but in the case of the coal trade the railways do not weigh the bulk of the coal wagons—the Coal Board is made to declare the weights. The Coal Board has to provide the weighing machine and supply the weights to the Railway authority.

Another instance is that of the conveyance of bricks. The bricks are loaded at some private siding, and very often are never taken near a place where they can be weighed by the railway authorities. The trader is, therefore, called upon to declare the weight. The railway authorities send an inspector round to weigh small quantities of bricks picked out at random, and thus argue that a larger quantity will weigh in the same ratio.

(4) *The detention of trucks* beyond a reasonable period by the trader is subject to a *demurrage charge* imposed by the railway; and a trader can also be charged if he loads up his goods and then neglects to give a consignment note stating their destination.

(5) *Provision of accommodation at a waterside wharf* and any services rendered thereat.

In some cases, in the collection and delivery of goods, there are services which the railway authorities need not render at all unless they choose. The great bulk of the railways of the world do not render the services of collection and delivery. They confine themselves to station and station, and the cartage work is left as an outside industry to be carried on by firms of local carriers. Hence, among this list of services there are two distinct and different kinds—

(1) A batch that the railway authorities *must* at times render, and which they are under legal obligation to render.

(2) Another batch where they are under no legal obligation at all to render, since it is a purely voluntary act; and if they render these services, they must not charge more than a "reasonable sum."

Calculation of a Rate. The procedure for the calculation of any commodity coming within any one of the twenty-one classes above mentioned is as follows—

I. Refer to the "General Classification" in order to find out the class to which the particular commodity belongs.

II. Ascertain from a railway guide the distance the goods are to be transported.

III. Calculate the rate for conveyance according to the particular class.

IV. Add to the No. III the station and service terminals, together with the charge made for cartage.

Railway authorities are compelled to keep rate books at their stations containing the rates to be charged for freight in each of the twenty-one classes into which "Goods and Minerals" are divided. They may not charge any rate to the public which does not appear in those rate books. Any such rate would be illegal. Moreover, the rate books must be open for inspection, without fee, at all reasonable hours whilst the station is open. These conditions are the guarantee to the public that the treatment they receive shall be equal. Since the existence of the preferential treatment of one person over another depends upon secrecy, the importance of keeping the rate books open to the public inspection is self-evident.

OWNER'S RISK.—Goods may be dispatched at "Railway's risk" in which case the Transport Commission is responsible for their safe delivery; or they may be sent "Owner's risk," in which case the Transport Commission is freed from all liability except as regards damage caused by the neglect of its servants. In consideration of being relieved of the ordinary risks of the journey the railway charges a smaller fee for its services. Every consignment of merchandise forwarded at owner's risk rates must be addressed in accordance with the Commission's regulations, and must be accompanied by a consignment note on which shall be stated that the consignment is to be carried at "O.R." or "Owner's risk." The traffics to which the scale applies are indicated in the classification of goods by the letters *a, b, c, d, e, f, g,* or *h.* Other traffics are charged at the "Railway's risk" standard rate in the absence of an exceptional rate.

RETURNED EMPTIES.—There is also a special scale of charges for "returned empties."

"Returned empties" here mean that the "empties" are sent from the same station and from the same consignee to which and to whom they were carried, and they must be returned to the same station and the same consignor from whom they were carried. Thus, in the case of a "returned empty"—

(1) The terminal stations must be the same.

(2) The consignor and the consignee must be the same, except that their positions are reversed.

Empties which are not "returned empties" are charged at much higher rates, and, therefore, the word "returned" makes a considerable difference in the expense involved by the trader.

DANGEROUS GOODS.—There is also a special classification for explosives and other dangerous goods for conveyance by merchandise trains, and only those provided for in this classification will be accepted by the companies. The question whether goods are dangerous is determined by the Transport Tribunal, and such goods are subject to an indemnity which was imposed for the first time by the Railways Act, 1921.

PERISHABLE GOODS.—Up to the passing of the Act of 1888 the carriage of goods by passenger train was a purely voluntary act on the part of the railways. The only types of goods they were compelled to carry up to that time were the personal luggage of passengers, mails sent by the Post Office, and Parcels Post.

Under the Railway and Canal Traffic Act of 1888 and the Order Confirmation Acts of 1891–92, this position was altered, and for certain classes of traffic it was made an obligation on the railway companies to carry certain traffic by passenger train. Reasonable facilities were to be afforded for the expeditious conveyance of perishables, although such facilities were to be subject to the convenient and punctual working of the passenger train service. It should be noted, however, that only perishables given in a particular list were to be conveyed compulsorily by the companies. This list of perishables can be divided roughly into four classes—

(1) Dairy and poultry farm produce (e.g. butter, milk, cheese, eggs, etc.).

(2) Fish and ice, which seem to go naturally together.

(3) Fruit and hot-house vegetables.

(4) Game, rabbits, and meat.

CONVEYANCE OF PARCELS BY PASSENGER TRAIN.—As has already been mentioned, the Transport Commission conveys small parcels by passenger train on payment of a fee in accordance with the authorised rates, provided the parcels do not contain anything of a fragile nature. The parcels must be delivered at the station from which they are to be sent at least ten minutes before the departure of the train by which they are intended to be forwarded. In all important towns, the Transport Commission collects free of charge, and also delivers free or charge within the ordinary delivery limits of principal stations.

When speaking of "parcels" by passenger train, the word "parcel" means a package. A package might consist of three or four parcels, provided they are firmly fastened together so as to make one package for purposes of handling.

To this rule there are exceptions—

(1) There may be an exception if, on arrival at destination, the parcel is required to be split up and delivered to different people. In that case, the charge has to be made as for separate parcels.

(2) There is also a statutory list of exceptions.

SMALL PARCELS BY GOODS TRAIN.—Any consignment not exceeding 3 cwts. is considered as coming under the heading of small parcels, for which there is a special scale of charges. The term "parcel" is here used to signify a consignment which may

consist of several parcels or packages. There is a condition that the railway is entitled to insist on every parcel weighing 14 lbs. and, if it does not, to charge for each parcel as 14 lbs. In practice, however, little notice is taken of this provision. A minimum of 28 lbs. in weight may be charged for by the railway authorities, and this is taken full advantage of by them. Reference to the scale for small parcels in the General Railway Classification Book will show that nothing less than a quarter is quoted.

RAILWAY CLEARING HOUSE.—As it was practically impossible before nationalisation to convey goods or passengers any considerable distance without having to traverse the lines of more than one company, some device had to be introduced to enable the different railway companies to divide between them the through fares or goods rates. This was effected by the institution of the Railway Clearing House in the year 1842, which obtained Parliamentary recognition by the *Railway Clearing Act* of 1850. All traffic which passed over more than two companies' lines was dealt with here. The various companies rendered to the Clearing House a monthly return of all through bookings, whether passengers, goods, parcels, or any other kind of traffic; and the business of the Clearing House was to deal with these returns in such a manner that each company was credited with its fair share of these bookings. When two companies only were concerned, the division of the receipts was usually a matter of mutual arrangement, and was not dealt with through the Clearing House.

Now that the railways have been nationalised the Clearing House is managed by a committee consisting of five members of the Transport Commission, four chief Regional Officers of the Transport Commission, one member of the London Transport Executive and one member from each of the Irish Railway Companies.

FUTURE DEVELOPMENT.—During the war the railway system of this country suffered severe damage from enemy action, and a long backlog of maintenance and development was incurred. In 1955 a scheme of modernisation and re-equipment to be spread over fifteen years was announced. £1,200 million are to be invested on this scheme. Diesel and electric traction are to be introduced by stages until they are the principal methods of traction, and steam traction will decline in importance. The carrying out of this scheme should bring us, in a few years time, a vastly improved railway system.

TEST PAPER

1. Into how many classes may railway rates be divided ?

2. State the number of classes into which goods and minerals are divided for the purpose of fixing railway rates.

3. Explain the principle which determines the class into which a commodity is entered for the purposes of the " General Railway Classification of Goods by Merchandise Trains."

4. What is meant by the charge for station terminals ?

5. Explain what is included under the heading of service terminals.

6. What in your opinion are the reasons for the standard rates of conveyance, decreasing as the distance increases?

7. Mention any services which railway authorities may charge for, but for which they are restricted to a reasonable sum.

8. On what basis does a railway charge for conveying goods from one town to another?

9. Why does it cost more to convey a ton of worsted coatings by rail between Bradford and London than a ton of raw wool ?

10. What is meant by Class Rates ?

11. Name any classes of goods other than goods and minerals for which there is a special scale of charges for conveyance by rail.

12. Explain the meaning of "returned empties."

13. What was the object of the Railway Clearing House?

14. Explain the following : " Owner's risk " rates ; perishable goods ; railway's risk.

15. Indicate the factors that are taken into account by the Transport Commission when classifying goods offered for conveyance by rail. Has the trader any means of redress if his goods, in his opinion, are wrongly classified? If so, explain the procedure.

CHAPTER L

OCEAN TRANSPORT

IMPORTANCE OF SHIPPING.—It would be difficult to exaggerate the importance of the shipping industry in the economic life of this country. As the Balfour Committee pointed out, the fact that the bulk of our external trade is carried by sea, while in addition coastwise steamers perform to a large extent the transport services rendered in some other countries by river and canal, it is clear that ready access to an adequate supply of efficient sea-carrying power on reasonable terms is one of the prime conditions of competitive power. From the time when the iron ship began to drive the wooden ship off the high seas in the middle of the nineteenth century and our merchant marine repelled the challenge of American shipping, British ships dominated the carrying trade of the world up to 1914. In the past decade that supremacy has been challenged by many countries, who have attempted by direct subsidy, by restrictive conditions in coastwise trade, and in other ways, to create for themselves a merchant fleet of their own. Yet, even to-day, over one-half of the tonnage passing through the Suez Canal flies the British flag, whilst British ships carry 90 per cent of inter-Imperial trade, 60 per cent of the trade between the Empire and foreign countries, and 25 per cent of exclusively foreign trade.

The ship is by far the largest vehicle which has ever been devised by man, and its cargo-carrying capacity is greater than that of any other single transport unit. As compared with the motor vehicle or even the railway train, the cargo space available on the modern ship is enormous, whilst developments in shipbuilding technique are constantly increasing the cargo space in relation to the total capacity of the ship. The vessel can be operated with a relatively limited crew, whilst its permanent way is provided freely by Nature. Consequently, goods can be transported more cheaply by this method than by any other. Furthermore, competitive conditions normally prevailing in the shipping industry operate to keep these charges down to a minimum, which benefits the trader in the freight charges which he pays on his goods. At the same time, it may create

difficulties for those engaged in the industry and invite action to restrain the competitive struggle.

One development which has occurred in recent years—the large-scale transfer from coal-using to oil-using vessels—has been of considerable economic significance to this country. Formerly the mining industry of this country supplied a large amount of coal annually for bunkering ships and maintained coaling stations all over the world. The maintenance of stocks at these stations provided outward cargoes for a considerable tonnage of ships.

CLASSIFICATION OF SHIPPING.—The facilities afforded by shipping firms may be classified according to the type of carrying function which they perform, namely, the conveyance of passengers and of merchandise. This classification is not, however, a particularly good one, since there is no clear line of distinction between the vessels engaged in these two types of traffic. It is true, of course, that luxury liners, such as the *Queen Mary*, cater mainly for the requirements of passengers, but at the same time they perform a certain amount of cargo-carrying work in connection with goods of the more expensive types. On the other hand, ships devoted mainly to cargo-carrying work often carry a certain number of passengers as well. Between these two extremes we find ships engaged in both classes of work in varying proportions. We may, however, adopt a classification based on the manner in which a line is organised, and may distinguish the following classes.

(1) **Passenger Liner Services.** The essence of a liner system is the maintenance on a given route of a regular service of ships sailing on advertised dates, whether full or not. The liner under this heading is designed primarily for the carriage of passengers and mails, and is therefore designed for both speed and luxury. The Atlantic trade has provided conditions which have allowed the development of this tendency to the greatest extent. The transatlantic service by steam has now been in existence for well over a hundred years, and for practically the whole of that period the ships on it have been the largest, finest, and fastest in the world.

(2) **Cargo Liners.** This type of vessel carries larger quantities of merchandise and fewer passengers than the foregoing, whilst her accommodation is not usually of such a luxurious order. These vessels usually operate on routes where speed is not the main requirement, and where cargo as well as passengers make her running a

OCEAN LINER ROUTES

Route	Area Served	Ports of Departure	Ports of Call
I. North Atlantic Route.	This route links the ports of Western Europe with those of the East of North America. Besides Canadian products, cotton and fruit are derived from the eastern States of the U.S.A.	Glasgow, Liverpool, Manchester, Avonmouth, Southampton, Dover, and London.	Quebec and Montreal (summer only), Halifax, St. John, Boston, New York, Baltimore, Charleston, Galveston, and New Orleans.
II. Suez-Canal Route.	This route commands the markets of Eastern Africa, Persia, Arabia, India, the Far East, and Australia. Besides the special Indian, East African and Australian products, the trade includes Arabian gum, Persian carpets, and opium, East Indian sugar and spices, Manila hemp and tobacco, Chinese tea and silk; and the products of the Mediterranean—fruit, wine, maize, wheat and cotton.	London, Liverpool, and Southampton.	Lisbon, Gibraltar, Algiers, Marseilles, Genoa, Naples, Malta, Port Said, Aden, and Bombay; Calcutta, Penang, Singapore, Manila, and Hong-Kong; Perth, Adelaide, Melbourne, and Sydney; Mombasa, Zanzibar, Mozambique, Delagoa Bay, and Durban.
III. The Cape Route.	Besides the special South African and West African products, the trade along this route includes the rubber, palm oil, and ivory of the Congo. The route also controls part of the Australian market.	London, Liverpool, Southampton, and the Severn Ports (Bristol, Cardiff, and Swansea).	Madeira, Las Palmas, Teneriffe, Ascension, St. Helena, Capetown, Port Elizabeth, and East London; Capetown, Fremantle, Adelaide, Melbourne, Sydney, and Brisbane.
IV. The Plate Route.	This route includes the Brazil trade in rubber, coffee, rosewood, diamonds, and the typical Plate trade in grain, wool, and meat.	Liverpool, Southampton, Glasgow, Manchester, and London.	Lisbon, Madeira, St. Vincent (Cape Verde Is.), Manaos, Pernambuco, Bahia, Rio de Janeiro, Santos, Monte Video, Buenos Aires, Rosario, Punta Arenas.
V. The West Indian Route.	Besides the special West Indian products of sugar, bananas, and raw cotton, the trade includes Mexican mahogany, tobacco, and silver.	Bristol, Manchester, Southampton, and Liverpool.	New Orleans, Galveston, Kingston (Jamaica), Havana, Vera Cruz, and Tampico.
VI. The Panama Route.	This route taps the Pacific coasts of America and constitutes a direct route to New Zealand.	Southampton, Liverpool, and London.	Colon, Pacific Coast, and New Zealand Ports.

paying proposition. They include many of the fastest and most efficient freighters, and they are generally fitted for the particular traffic on the routes on which they operate. Thus, many of them are equipped with refrigerating machinery and insulated holds for the carriage of meat or of other perishable cargoes. These boats, in common with the passenger liners, operate on a fixed time-table, so that they provide a service which can be relied upon by traders who have to make delivery of goods in a stipulated period.

(8) **Tramps.** The main features of the tramp system are that, unlike the liners, the tramp has no fixed itinerary and sails only if she has a cargo to carry or one in prospect. Fleets of tramp steamers may be compared with fleets of cabs waiting for employment in the streets, and ready to carry out their fares' instructions. Normally, the tramp vessel, like a taxicab on the ranks, is in a position to be chartered at any moment. Her owners try to secure outward and homeward freights, fitting well together to make a complete round venture. The shipper, or shippers, charter a vessel to go where required, but she does not normally take cargo in parcels as the liners do, but deals almost entirely with full cargoes. The seasonal movements of trade give tramp vessels their great opportunities for employment, such as the trade in grain and other commodities harvested at definite seasons.

THE CONFERENCE SYSTEM.—The object of a liner company is to maintain a regular service along specified routes, but in order to perform this function the company must be in a position to rely upon the regular support of shippers. As we have already pointed out, the sea is a highway which is free to all persons, and a vessel may sail on it without purchasing a right of way. A railway is tied to its own route, but a ship is free to move where it wishes. Hence it is difficult to restrict the shipments on any given ocean route to a single carrier or combination of carriers. Yet, the position of a liner company may be rendered almost untenable if tramps are able to cut in at any time when conditions are favourable and take all the most profitable cargo at rates which are much lower than those which the liner company can afford to accept.

A partial restriction of liner competition has been possible because it is a costly venture to establish a line of fast steamers. The number of ocean lines is consequently limited, and if the small number of rivals can come to an agreement as to rates, division of traffic, or

pooling of earnings, competition can be regulated and some measure of monopoly can be established. In order to protect the services which they have organised, shipowners in all the great trades have formed themselves into *Shipping Conferences*, which are periodical meetings of the representatives of the various lines concerned in each particular trade to discuss matters which affect that trade and to agree upon uniform rates for the various classes of cargo. Each conference has its own area, and in certain cases where several trade routes intersect or adjoin one another, the various conferences have understandings or agreements with one another to respect each other's spheres of influence.

The principal advantages claimed for the system are that by means of conferences regular sailings and systematic rates of freight are obtained. The greater regularity of sailings is serviceable to merchants, since it is not necessary to engage cargo space a long time in advance, and definite dates can be assigned for the delivery of goods. By the adoption of uniform freight rates, combined with stability, shippers can calculate transport costs with a feeling of security. At the same time, discrimination of rates in favour of the large shipper is eliminated. On the other hand, it has been urged that such conferences led to dictatorial methods on the part of members; that their policy was one of high freights, and that State supervision of their activities was required. More recently they have been criticised from within on the ground that the company which has been enterprising enough to build up the finest fleet has to carry its weaker associates. There is also the difficulty of getting all parties to adhere honourably to the conditions they have themselves laid down.

DEFERRED REBATE SYSTEM.—The tie with the shippers of the goods that the conference lines seek to establish is secured in a variety of ways, the chief of which is known as the deferred rebate system. The conferences could not provide the benefits of stability of rates and regularity of service unless they had some assurances of continuous support from their customers. The fact that a trade was open to all shipowners would lead to the incursion of outside ships at times when the trade was flourishing, but these outside ships would quickly disappear when the seasonal or periodic depression set in, leaving the regular lines to bear the brunt of this depression. The conferences adopt the view that they could not

continue in times of bad trade to furnish regular services in which ships often sail with little cargo unless in times of good trade they are permitted to carry all the cargo offering.

The deferred rebate system operates in the following manner. The companies comprising the conference issue a notice to shippers informing them that, if at the end of a certain period, say six months, they have not shipped goods by any vessels other than those dispatched by members of the conference, they will be credited with a sum equivalent to a certain part (usually 10 per cent) of the aggregate freights paid on their shipments during that period. This sum will be paid over to them, however, only if at the end of a further six months they have continued to confine their shipments to vessels belonging to members of the conference. The sum paid in this way is known as a deferred rebate. If a shipper has consigned goods by more than one company in the conference, he claims from each of those companies the amount of rebates due upon his shipments in each case.

The shipowners claim that they are able, by means of the deferred rebate system, to confer the following advantages on their customers.

(1) Greater stability of freight rates is possible. Before the introduction of the rebate system, freights were subject to sudden fluctuations, which led to sudden changes in the values of imported stocks. Under the rebate system, however, rates are stable, except for progressive reductions or increases.

(2) There is equality of rates for all shippers, whether large or small, as regards general merchandise. The only exceptions are full or large cargoes of heavy materials, such as steel rails, which may be the subject of special contracts, since they are suitable for carriage by tramps and may otherwise be taken that way.

(3) Conference lines operating the system supply frequent, regular, and efficient services, and from the point of view of the shipper this is worth some concession.

(4) In the days before the introduction of the rebate system it was customary for shipowners on occasions to buy goods on their own account to fill up their ships, thus competing with the merchants; whereas, under the rebate system, it is tacitly understood that shipowners will not make any shipments on their own account.

Shippers, in general, admit these advantages, but express certain objections to the working of the system. They contend that it

enables steamship conferences to maintain a monopoly and to set limitations to the shippers' freedom of action. They point out that the shipowners tie their customers to them, and thus render it difficult for any other shipowner to start a service in their particular trade. The following complaints have also been made—

(1) The periods adopted in connection with the system are too long, and that even when the deferred rebate is due, a delay of months may occur in checking and adjusting the claim.

(2) That the system keeps large amounts of the shippers' capital locked up.

(3) That the system is too complex and entails an undue amount of clerical labour.

Another form of the tie is the *Agreement System,* which takes the form of a contract whereby a trader undertakes during a defined future period to give all his custom to the conference, and in return is charged a lower rate of freight than shippers who have entered into no such agreement. In return, the lines undertake to maintain regular sailings at advertised dates, the ships to sail full or not full, and to provide sufficient tonnage for the ordinary requirements of the trade. Further, they agree to maintain stability of freights, which are definitely prescribed in the agreement, and equality of rates to large and small shippers alike. This system is in force in the South African trade, since deferred rebates are forbidden by South African law. In the Australian and New Zealand trades, traders have the option of using either deferred rebates or the agreement system on equal terms.

SHIPPING DOCUMENTS.—The document constituting the contract of carriage by sea depends upon whether goods are being consigned in relatively small quantities, or by the shipload. In the former case, the contract is contained in a bill of lading, but in the latter, a charter party. The characteristics of these documents are as follows—

The Charter Party. When goods are to be forwarded in large consignments, it may be to the interest of the merchant to hire or charter a ship. The centre of the chartering business is London, and the persons who undertake this kind of work are shipbrokers. The contract which constitutes the basis of the chartering is known as the "Charter Party." This ancient document, which used to be made out in two parts. commences by warranting that the ship

Charter Party

LONDON, Jan. 8th, 19..

IT IS THIS DAY MUTUALLY AGREED BETWEEN *Morning Steamship Co., Ltd.*, *Owners* of the good Steam Ship called the "*Sunrise*" of the measurement of 1,500 Tons Nett Register, 2,700 Tons dead weight cargo capacity guaranteed, classed 100 *A*1 Lloyd's or equal thereto, now *lying at Valencia* and *Jones Jones & Co.*, of *Liverpool* Charterers, THAT the said Steamer being tight, staunch, and strong, and in every way fitted for the voyage shall with all convenient speed, sail and proceed to *Liverpool*
or so near thereunto as she may safely get, and there load, always afloat, from the Factors of the said Affreighters, a full and complete cargo, consisting of lawful merchandise,
which the said Affreighters bind themselves to ship, not exceeding what she can reasonably stow and carry over and above her Tackle, Apparel, Provisions, and Furniture; and being so loaded shall therewith proceed as ordered on signing Bills of Lading to

Bombay,

or so near thereunto as she may safely get, and deliver the same, always afloat, on being paid Freight as follows—

Twenty-two shillings per ton,

being in full of all Port Charges and Pilotage as customary.

1.—The Freight to be paid at Port of Discharge on unloading and true delivery of the Cargo in Cash at current rate of exchange.

2.—As much Cash as Master may require for Ship's ordinary disbursements at Port of Loading, not exceeding £30 to be advanced (if required), subject to 3 per cent. for Interest and Insurance.

3.—Merchants have the full range of Vessel's holds, including cross and half-deck bunkers if any, and right of shipping Cargo on deck (at their risk), in so far as compatible with Steamer's seaworthiness.

4.— *Five* days, Sundays, and holidays excepted, are to be allowed the said Merchant (if Ship be not sooner despatched, Charterers having liberty to load up to midnight) for loading and discharging, but time occupied in shifting ports not to count, and *two* days on demurrage over and above the said laying days at *three* pence per nett register ton per day. Lay days in each port to count from Captain's notice of readiness for loading and discharging. Charterers to have option of loading and discharging on Sundays and holidays, such days to count as lay days for time actually occupied.

5.—The Act of God, perils of the sea, fire on board, in hulk or craft, or on shore, barratry of the Master and Crew, enemies, pirates, and thieves, arrests and restraints of princes, rulers, and people, collisions, stranding, and other accidents of navigation, excepted, even when occasioned by negligence, default or error in judgment of the Pilot, Master, Mariners, or other servants of the Shipowners. Not answerable for any loss or damage arising from explosion, bursting of boilers, breakage of shafts, or any latent defect in the machinery or hull, not resulting from want of due diligence by the Owners of the Ship, or any of them, or by the Ship's Husband or Manager.

6.—The Ship has liberty to call at any ports in any order, to sail without Pilots, to tow and assist vessels in distress, and to deviate for the purpose of saving life or property.

7.—The Cargo to be brought to and taken from alongside the Ship at Merchants' risk and expense.

8.—The Captain to sign Bills of Lading as presented, if in accordance with Mate's receipts, and at any rate of Freight, without prejudice or reference to this Charter Party, if not at variance therewith, the owners having a lien on the Cargo for Freight, Dead Freight, and Demurrage. Should the total Freight shown by Bills of Lading amount to less than the Freight stipulated by this Charter the difference to be paid to Captain before sailing, and should the Freight shown by Bills of Lading amount to more than the Freight stipulated by this Charter, the difference to be paid before sailing to Charterers by Captain's Draft on Owners, payable 48 hours after arrival at discharging port.

9.—The Captain to telegraph arrival at outward discharging part to *Owners at Newcastle* also to telegraph them his departure for loading port.

10.—Steamer not answerable for leakage or breakage, unless occasioned by bad stowage of cargo.

11.—Lay days not to commence before the *25th day of March,* 19.. and should Steamer not arrive and be ready to load at first loading port on or before *5th day April* Charterers to have the option of cancelling this Charter.

12.—Any difference respecting the interpretation of this Charter to be settled in accordance with the custom of the port where it arises.

13.— *Five* per cent. Address Commission is payable to Charterers at port of loading. Vessel to be addressed at ports of loading and discharge to Charterers or their Agents, paying the customary fees for transacting Steamer's business, and to employ Charterers' stevedores for loading and discharging at not exceeding customary rates. Charterers to have the use of Steamer's winches, Captain supplying necessary men and coals to work same.

14.— *Five* per cent. Brokerage on the amount of Freight is due by the Ship on the signing hereof to

ship lost or not lost.

15.—Penalty for non-performance of this Agreement, estimated amount of damages.

Morning Steamship Co., Ltd.
A. Coxon, Managing Director.

Witness to the Signature *of M. S. S. Co.,*

A. H. Green
of Jones Jones & C
Wm. Hughes

pp. Jones Jones & Co.
Hughes Jones

is staunch and strong, and goes on to define the conditions of hire, etc. The captain and crew regard the charterer as the interim holder, and they take their instructions from him.

A specimen Charter Party is shown on pages 539 and 540.

From the Charter Party, it will be seen that the chief items of agreement are—

(1) The places between which the ship is to go;

(2) The cargo to be carried;

(3) The freight to be paid for the work.

There are also some minor items, such as the manner in which the freight is to be paid; the number of days, called *lay days*, which the shipowner is willing to allow his ship to remain in port for the purpose of loading and unloading; and the sum to be paid per day for any time she is detained by the charterer over and above the number of days mentioned in the contract. This last payment is known as "demurrage," and should be collected by the master of the ship from the charterer or his agents as it becomes due.

If the payment to the shipowner is to be made at an agreed rate per ton, and the charterer is unable to provide sufficient goods to make up a full cargo, he must pay him for as much cargo as would fill the space left empty in the ship, which is called the "*dead*" freight. If he has agreed to pay a certain sum, however, —called a "lump sum"—for the use of the ship, it is not material to the shipowner what empty space is left, provided that his ship is so loaded as to be seaworthy. It is not necessary that the whole cargo should be the actual property of the charterer, but he may allow others besides himself to use part of it. Indeed, he may advertise her to load as a "General ship," that is, to convey goods for third parties to the port or ports for which he has chartered, provided he keeps within the terms of the Charter Party.

Bill of Lading. When goods are placed on board a "General Ship," a Bill of Lading is employed. The Bill of Lading is regarded as the captain's or the shipowner's receipt for the goods. It begins with an acknowledgment that the goods have been shipped, and undertakes that (certain perils excepted) they shall be delivered in a fit condition at the destination named.

The Bill of Lading carried on board the vessel is a duplicate of the document given by the master to the shipper of the goods at the time of the shipment. It specifies the name

of the shipper; the date and place of the shipment; the name and destination of the vessel; the description, quality, and destination of the goods; and the freights which are to be paid.

When the ship arrives, the holder of the Bill of Lading is entitled to the possession of the goods. This is presented to the captain or ship's agent, who then gives permission for the goods to be handed over to the owner. Moreover, the ownership of the goods may be further transferred by the mere endorsement of the Bill of Lading to a new owner.

Hence, it may be said that a Bill of Lading is the captain's acknowledgment that he has received the goods on board on the terms and conditions expressed therein; whereas a Charter Party is an agreement for the loan or hire of a ship, and conveys no title whatever to any cargo.

Freight Rates. The rates of freight for the outward journey are charged according to tariff. In this, the goods are arranged in classes, which are based chiefly upon the value of the goods, a higher rate of freight being charged for those of higher, than for those of smaller, value. The freight may depend upon the weight of the goods or upon their cubic capacity. Light or bulky goods are usually charged according to measurement, a ton of shipping being regarded as 40 cub. ft. In the case of heavy goods, the ordinary ton of 20 cwts. is taken.

A freight ton, however, is a very variable measure. In some trades, it is calculated at 50 cub. ft., whilst in the case of certain imports, the weight of a "ton" is made to vary. For example, a freight ton of rice is 20 cwts.; while a freight ton of pepper, which has less weight for the same bulk, is 11 cwts. These variations are always expressed on the Bill of Lading, and it is, therefore, quite easy to examine the "freight notes," which are rendered either for import or export goods.

Precious metals, coins, valuable jewellery, etc., are carried at a rate which is based upon their value (i.e. about $\frac{1}{4}$ to $2\frac{1}{2}$ per cent). Explosives and other dangerous objects are either not accepted, or carried under special terms and conditions.

For the return journey, the rates of freight are more often a matter of agreement between the shipping agents and the consignor. It is sometimes based on a measurement ton of 40 or 50 cub. ft., according to the nature of the goods; upon the ton

weight; and often per quarter, which is then determined according to the quality and nature of the goods. Thus, wheat and maize may be calculated at 480 lbs. per quarter, 256 lbs. in the case of oats. For cereals from America to Liverpool, the freight is usually charged in pence per bushel, which is taken as equivalent to 60 lbs. Freight rates for timber are usually expressed per *standard* (i.e. for 165 cub. ft.).

SHIPPING AND THE STATE.—The predominant position of British shipping in the world before 1914 was attained as the result of sustained initiative and self-reliance of the individual shipowner. Since the First World War, however, national control and State support have found such definite and widespread expression in the shipping policies of foreign maritime countries, that the British position in the carrying trade of the world has suffered a serious reverse. The *causes of the difficulties* of British shipping are many. Chief among them are decline in international trade; high rates of taxation; high running costs as compared with foreign shipping due to the higher wages paid and to restrictions from which competitors under other flags are exempt; and the activity of foreign Governments which, by subsidies and in other ways, have stimulated uneconomic competition for the transport of a diminished volume of trade. All classes of shipping have been affected, but the hardest hit have been the *tramp steamers*, since the liner companies can, to a certain extent through the conference system, protect themselves against the worst effects of rate cutting. The question has therefore arisen in an acute form in recent years: Can the unaided efforts of the British shipowner continue for any further appreciable length of time to cope successfully with foreign competition, now that the latter is so determinedly buttressed by State support?

The paramount need of British shipping, as of all shipping, is the restoration of world trade by the removal of restrictions and uneconomic practices, including subsidies. An attempt was made at the World Economic Conference in 1933 to secure international agreement to this end, but the attempt failed. Parliament was, therefore, led to pass the British Shipping (Assistance) Acts, 1935–7, which provided an annual subsidy not exceeding £2 million for the purpose of helping the owners of vessels registered at ports in the United Kingdom to compete with foreign shipping in receipt of subsidies from foreign Governments.

On 28th March, 1939, proposals for extending the subsidy scheme were announced in the House of Commons on the lines of that which had previously been in operation, but with some alterations as a result of adopting a five-year period instead of an annual basis. The sum of £2,750,000 a year was to be made available for tramp shipping, including vessels in the deep seas and near trades, but not the coasting trade. In each year the amount of subsidy would be subject to an arrangement for determining by reference to the index number of shipping freights whether subsidy should be paid in full or otherwise. Conditions would be attached to the subsidy, similar to those attaching to the previous subsidy, regarding employment of British crews and compliance with the National Maritime Board Agreements, where applicable.

In the liner section of the industry, an Advisory Committee was to be set up for an experimental period of two years, to examine requests for assistance from liner companies whose services were endangered by subsidised foreign competition, and to advise the Government accordingly. Parliament would be asked to make provision to enable the Government to grant financial aid promptly in cases where it had been decided that such assistance was necessary.

The proposals also included provisions for fitting the British Mercantile Marine to take its vital part in national defence; and financial arrangements for a fresh beginning with the building of merchant ships in this country, which had been dwindling rapidly, since, owing to the effects of rearmament, prices had risen to levels that made construction prohibitive in the prevailing poor state of the freight markets.

As a condition of making the subsidy available, the Government expected the shipping industry to do its utmost to promote international measures tending to adjust the supply of tramp tonnage to the demand so as to safeguard the level of freight rates. The industry was also expected to organise itself so as to satisfy the Government that at the end of the subsidy period it would be in a better position to maintain itself without Government assistance.

During the war shipping was subject to Government control. In September, 1947, this control was partly relaxed when the shipping industry was permitted to form the Shipping Advisory and Allocation Committee, which was responsible for allocating the available deep-sea tonnage required for the Government's programme of

dry-cargo imports. Shipping controls came to an end in December, 1948. The schedule of controlled freight rates which had existed for Government sponsored cargoes no longer applied except in the case of coastal shipping.

TEST PAPER

1. To what extent and in what direction are the conditions of ocean transport different from and similar to the conditions of land transport?
2. Enumerate three important highways of ocean commerce, and describe the nature of the trade which passes over each of them.
3. Into what main classes may British shipping be divided?
4. What are the purposes for which shipping conferences are organised? Explain the methods employed to make the decisions of the conferences effective.
5. Ocean transport services may be divided into three types? Describe briefly the services fulfilled by each type.
6. Describe three different types of cargo steamers, stating for what trade or trades they are most suitable.
7. "On the ocean, as on the land, charges for the carriage of heavy goods in bulk are governed mainly by the costs of the services rendered; while the charges for quick transport at fixed times are in great measure adjusted to demands for services rendered." Discuss the reasons for fixing ocean freights according to the above principle.
8. What are the necessary contents of a Charter Party?
9. Consider the effects of the modern specialisation of ships on the shipping industry and overseas trade.
10. What is a bill of lading? Explain its importance in respect of the carriage of goods and of a sale of the goods. Is it a negotiable instrument?
11. What are shipping conferences and how do they seek to control ocean freight rates?

CHAPTER LI

INSURANCE (I)

GENERAL FEATURES AND MARINE INSURANCE

IMPORTANCE OF INSURANCE.—Insurance plays an important part in both private and business life because risk in various forms is inherent in every form of human activity and insurance is concerned with the spreading of risk. The function of insurance was expressed in the preamble to an Act of Parliament in 1601—"by means of which policies of assurance . . . the loss lighteth rather easily upon many than heavily upon few"—and this is as true to-day as when the passage was drafted some 350 years ago. Moreover, with increase in the size of risk, almost from year to year, insurance plays an ever-growing part in social and economic life. Insurance began at home, but it extended overseas, and to-day over 70 per cent of fire and accident insurance alone is sold overseas. Insurance is thus a considerable invisible export.

Insurance has a statistical basis, and it is dependent on the law of average or the law of large numbers. A mathematical value may be given to many risks, especially in life assurance, and for this purpose it is necessary to use a sufficiently large sample of lives. The same principles are applicable to other classes of business, although it is more difficult to secure a sufficiently large number of similar cases in similar circumstances to provide a reasonable basis for arriving at a theoretical value of the risk to apply generally. There are some risks which cannot be insured because they are not susceptible to these principles on which insurance is based; for example, loss to a retailer through his stock becoming out of date by a sudden and radical change in ladies' fashions.

Insurers, in turn, spread the risks that they accept by means of reinsurance. This has become increasingly necessary with growth in the size of risks. If an insurer accepts an insurance for a very large sum, it may "cede" to other insurers the balance above its own "retention" by making special arrangements for the individual insurance concerned. This is termed *facultative reinsurance*. To-day, however, there are usually automatic reinsurance facilities in force under so-called treaties, so that an insurer can interest reinsurers,

without first seeking their confirmation, up to the limit provided by the treaty. For very heavy risks (for example, nuclear reactors) pools are formed so that risks can be spread over the market generally.

THE INSURANCE MARKET.—Insurance is a service—a promise to pay at some future date—but it is bought and sold in a market as is a material commodity.

The *sellers* are they who offer to insure, and this side of the market consists of insurance companies and Lloyd's underwriters. Insurance companies are divisible into proprietary companies and mutual companies. A proprietary company has shareholders and a share capital, whereas a mutual company is an association of policyholders who are themselves the proprietors of the undertaking. They share the profits and bear the losses, but some mutual companies are limited by guarantee. Mutual companies may transact business with the public generally, or may limit their activities to a certain section of the community. An underwriter at Lloyd's is in an entirely different position from any other insurer. The Corporation of Lloyd's does not itself accept risks, but through its Committee lays down stringent regulations with which underwriters have to comply to enable them to transact business. Each underwriter is personally liable to the whole extent of his fortune for risks which he insures, whether he operates alone or in a syndicate (see also p. 553).

The *buyers* of insurance are the public. They may be individuals, partnerships, limited companies, public authorities—indeed, any entity, incorporated or otherwise.

There are *intermediaries* to bring the buyers and sellers together. These consist of insurance agents and insurance brokers. An insurance agent may be a solicitor or other professional man, a garage proprietor, or any other person or firm a company chooses to appoint. Almost all insurance agents are part-time agents, and they do not profess to have expert knowledge of insurance. An insurance broker, however, is usually a full-time specialist of professional standing. A Lloyd's broker is one who has complied with the regulations of the Committee of Lloyd's, and he alone can place insurances with Lloyd's underwriters in "The Room" as it is called. Insurance companies are willing to deal with the public direct, although the bulk of insurance business is placed through agents or brokers. This is not so at Lloyd's where all business must be passed through

a Lloyd's broker, as noted above. (Industrial life assurance—see p. 580—necessitates frequent calls at the homes of the policyholders, and such calls are made by industrial assurance agents, but they are full-time employees of their companies and are thus in a category of their own.)

INSURANCE OR ASSURANCE.—These terms are used interchangeably. Nevertheless, the term assurance is usually reserved for life business because under almost every life policy there is sure to be a claim, sooner or later, since everyone dies eventually (or survives the fixed term under an endowment assurance—see p. 578—so that he himself collects the policy money). A fire, accident, or marine casualty, however, may or may not occur, so the term insurance is applied to fire, accident, and marine business.

A leading life company, however, is known as the Norwich Union Life Insurance Society. In the marine department, too, the policyholder is termed the assured and not the insured. The statute which regulates the business generally (including life assurance) is entitled the Insurance Companies Act, 1958.

BASIC PRINCIPLES.—Insurance contracts are subject to certain basic principles, irrespective of the type of insurance concerned. Every insurance contract is a contract of utmost good faith, that is to say, both parties must disclose all material facts. This is the only practicable basis on which to transact insurance because, as a rule, the insurers know nothing of the subject-matter of the proposed insurance and have to rely upon the information disclosed by the proposer. Every insurance contract, moreover, must be supported by insurable interest. This means, briefly, that the insured must have some legal relationship to the property or liability insured whereby he benefits by the preservation of the property or absence of liability and is prejudiced by loss of or damage to the property or the creation of liability.

Contracts of insurance, other than life and personal accident policies, are contracts of indemnity. This means that the insured is placed after a loss in the same position as far as possible as he occupied immediately before the loss. It would be contrary to public policy to allow the insured to make a profit out of a loss; it would tempt him to desire the insured event in order to obtain the money. Subrogation and contribution are corollaries of indemnity. If the insured has any alternative rights and remedies, then the insurers

are subrogated to such alternative rights and remedies in order to reduce or extinguish the loss that they have paid. If an insured holds more than one policy in respect of the same interest, risk and subject-matter, then each insurer is brought into contribution so that the loss is equitably distributed over the insurers.

INSURANCE COMPANIES ACT, 1958.—It is a tribute to the efficiency and probity of insurers that they are left comparatively free to transact their business. The underlying principle of this statute is "freedom with publicity"—freedom to operate on individual lines, subject to the safeguard of published accounts and returns in prescribed form.

The Act extends to the majority of classes of insurance business, and requires a minimum paid-up share capital of £50,000 with the maintenance of a stringent margin of solvency whereby assets must exceed liabilities by either £50,000 or one-tenth of the annual premium income of the company, whichever is the greater. Published accounts and balance sheets and certain claims statements in approved form have to be submitted annually to the Board of Trade. Special provisions apply to Lloyd's underwriters and to industrial life assurers. (Industrial life assurance is also governed by separate legislation, such as the Industrial Assurance Act, 1923, which *inter alia* set up the office of Industrial Assurance Commissioner.)

PROPOSAL FORMS.—A proposal to insure may be made orally, by means of a letter or on a completed proposal form. It is an almost invariable rule to require the completion of a proposal form when life assurance or any class of accident insurance is required. The form contains various questions which have to be answered, and it often incorporates a declaration in which the proposer warrants the truth of his statements. In marine insurance a "slip" is used instead of a proposal form.

COVER NOTES.—It is not always possible to calculate the premium to be charged and to prepare the policy forthwith. In such circumstances, temporary protection may be granted by means of a letter or cover note. For motor insurances the time as well as the date of issue of the cover note has to be shown, and a temporary certificate of insurance must be incorporated to comply with the requirements of the Road Traffic Acts.

POLICY FORMS.—The policy provides written evidence of the contract and sets out precisely the scope of the cover with the terms

and conditions of the insurance. If it is subsequently necessary to alter an insurance, a new policy may be issued or an endorsement may be prepared.

RENEWALS.—It is possible to arrange an insurance for a specific period only, but the majority of policies are renewable annually on payment of a renewal premium. A renewal notice is dispatched either to the insured direct or through an agent or broker, and when the premium has been paid a renewal receipt is issued to extend the insurance for a further year.

Days of grace are usually allowed in which to pay the renewal premium—15 for fire and accident insurance and 30 days for life—and so long as there has been no indication that the insurance was to be allowed to lapse, the insurers are on risk during the days of grace provided the premium is paid before their expiry. No days of grace are allowed, however, in marine, motor, and livestock insurance.

SCOPE.—Insurance provides protection against a wide range of contingencies. There are four branches of insurance—marine, fire, life, and accident—conducted by private enterprise. National insurance is different, and it is dealt with by the Ministry of Pensions and National Insurance.

The remainder of this chapter is concerned with marine business and in the succeeding chapter the other forms of insurance are studied.

MARINE INSURANCE

In all probability, the oldest form of insurance is that against risks which are likely to occur during sea transit, i.e. marine insurance. It is an arrangement by which one party agrees to compensate the owner of a ship or cargo for marine losses—that is to say, total or partial losses incidental to marine adventure. The person so agreeing is called the *underwriter*, since he writes his name under the policy in which he has guaranteed to pay a certain sum in the event of loss.

In addition to actual sea voyages, contracts of marine insurance may apply to inland waters or to land risks incidental to sea voyages. Marine underwriters also often undertake the insurance of ships under construction.

In 1906 the law governing the principles of marine insurance was codified in the Marine Insurance Act. This Act was not intended

to create new laws but rather to set out in statutory form the existing law, based upon previous legal decisions.

DIFFERENCE BETWEEN HULL, CARGO AND FREIGHT INSURANCE. The chief forms of interest covered are—

(1) **Hull.** This is the insurance effected by the shipowner on the ship, including the machinery.

(2) **Cargo.** Cargo insurance is effected by the owner of the cargo carried and, on sale of the goods, the policy may be assigned to the buyers.

(3) **Freight.** In this sense freight means the money earned by the shipowners for the carriage of goods or for the hire of the whole or part of the vessel. If freight is payable at destination, it is at the risk of the shipowner, and, if the adventure should be lost, the freight will likewise be lost. If, however, the freight is prepaid absolutely, it is at the risk of the cargo owner and it enhances the value of the cargo. In these latter circumstances, the freight is not insured as a separate item, but is merged in the value of the cargo insured under heading (2) above.

The foregoing remarks are generalisations; there are other parties besides the shipowner and cargo owner who may have an insurable interest in a maritime adventure, such as mortgagees, charterers, and bailees.

STRUCTURE OF THE MARINE INSURANCE MARKET IN LONDON.— London is generally regarded as the centre of the world marine insurance market. The business is underwritten by insurance companies and Lloyd's underwriters. Because of its world-wide connections and high reputation much insurance of foreign ships and cargoes takes place in the London insurance market, which is a valuable earner of foreign currencies.

There is also an important market of insurance companies in Liverpool, and at Glasgow a number of agents underwrite on behalf of the companies.

Lloyd's. This is an association of underwriters and other persons engaged in marine insurance and also, in more recent years, non-marine insurance. It had its origin in a coffee house kept by Edward Lloyd, which was the resort of persons interested in shipping matters, and for whose benefit the proprietor—long before the invention of modern means of communication—had established means of obtaining shipping news, not only by semaphore telegraphs

from the coast, but by correspondence from all places of trade throughout the world. The spirited proprietor of the old-fashioned coffee house is now perpetuated in the world-wide celebrity of the institution, which is unique in its facilities for obtaining news relating to the shipping and civil aviation, not only of the United Kingdom, but of all other countries. The intelligence department at Lloyd's is open day and night for distributing this information to the various subscribers throughout the world. The news is obtained through a world-wide organisation of Lloyd's Agents and Lloyd's Signal, Wireless, and Semaphore Stations. There is scarcely a port of any importance where there is not an agent for Lloyd's. Lloyd's agents furnish to the central establishment lists of all ships arriving at and departing from or passing the place they represent, together with the names of the places between which they are making their voyages. This and other information the masters of ships are willing and anxious to supply, in order that they may be reported for the benefit of their owners. Lloyd's agents are also expected to do what is in their power to protect the interests of the members of Lloyd's. Since they are always selected from the best and most reliable shipping agents or merchants, the interests of shipowners, merchants, and underwriters are always considered safe in their hands.

The shipping intelligence and other information is published by Lloyd's in a daily newspaper, entitled *Lloyd's List and Shipping Gazette* and also in a number of other publications.

Since the days of the original coffee house, Lloyd's have occupied several premises, each of which in turn became inadequate owing to the continued expansion of business. The present buildings in Lime Street, London, should provide sufficient accommodation to meet all the needs of the foreseeable future. Admission to the underwriting room, or "The Room," as it is generally called, is obtained by membership and subscription, only members having the privilege of carrying on underwriting business.

In the rostrum in the centre of the room hangs the Lutine Bell, which is rung when important announcements are made to the members. This bell was formerly the ship's bell of the frigate *Lutine*, which was wrecked on a sandbank in 1799, while carrying gold reported to be worth £1,400,000. The bell was subsequently recovered from the wreck.

Every underwriting member must satisfy the stringent tests of

solvency required by the Committee of Lloyd's. Each member underwrites business either personally or through an authorised underwriting agent. The members usually associate in groups known as syndicates, with one agent acting for each group. These syndicates are not partnerships; each member is liable only for his own personal underwriting liabilities and not for those of his associates.

Out of Lloyd's—the home of underwriters—there has arisen another institution known as "Lloyd's Registry of Shipping." This establishment issues annually to its subscribers a book called the "Register Book," which contains a list of ships registered in the British Isles, and of most foreign ships. For each ship particulars are given concerning, among other things, the date and place of construction, the materials of which she is built, details of her machinery, and her dimensions and registered tonnage. A ship may be assigned a class by the Society, such as "100A1," and will continue to hold that class so long as she is found, upon the prescribed periodical surveys, to be maintained in the condition provided for by the Society's rules.

Insurance Companies. Placed around Lloyd's are the marine departments of the insurance companies, making a compact marine insurance market.

An important distinction may be drawn here between Lloyd's underwriters and the companies. The Corporation of Lloyd's itself does not accept insurances; it merely provides facilities for business to be transacted by the members, and each underwriting member is personally liable for his underwriting debts to the full extent of his means (see also p. 547). An insurance company, however, has a salaried underwriter who accepts business on behalf of his company, and the liability of the shareholders is limited in accordance with the usual rules applicable to joint-stock companies.

The majority of insurance companies transacting marine business in London have considered it desirable to associate for the protection of their common interests, and with this object in view, the Institute of London Underwriters was founded in 1884. Similar bodies are the Liverpool Underwriters' Association (founded 1802) and Lloyd's Underwriters' Association (founded 1909).

Protecting and Indemnity Associations. Shipowners' contractual liabilities, such as damage to cargo carried under a contract of

affreightment, and also certain third-party liabilities, although not uninsurable in the marine insurance market by Lloyd's underwriters and the companies, are usually insured with the Shipowners' Mutual Protecting and Indemnity Associations. These are associations of shipowners who agree to contribute towards the losses of the members on a mutual basis. The Associations are non-profit-making organisations, and the contributions are collected rateably from the shipowners in proportion to the tonnage of the vessels entered.

METHOD OF PROCEDURE.—The general public are not admitted to the underwriting room at Lloyd's, and, as noted earlier, it is possible to place business at Lloyd's only through the medium of a Lloyd's broker. However, as far as insurance companies are concerned, business may be placed with them (*a*) through an insurance broker who may or may not be a Lloyd's broker, (*b*) direct by the prospective assured, or (*c*) through an agent of the company.

A marine insurance broker is not regarded as an agent of the insurers for, although he receives his commission from the insurers, he acts rather as an agent of the assured. The broker, being an expert exercising professional skill, should be capable of advising the assured as to the most suitable type of insurance for his needs, and by his knowledge of the marine insurance market he is able to place the insurance at the lowest rate of premium compatible with good security. When an insurance is placed through a broker, then although legally, in the event of loss, the insurer is directly liable to the assured for the payment of claims, it is customary for the assured to authorise the broker to collect the claim on his behalf and for this service the broker is entitled to charge collecting commission.

The method of procedure followed by a broker in placing an insurance is now considered. On receipt of instructions from his client, the broker writes upon a *slip* brief particulars of the insurance he desires to effect, viz.—

(1) Subject-matter to be insured, i.e. ship, freight, or cargo.

(2) The name of the carrying steamer or other conveyance, for cargo insurances.

(3) The voyage or period of time to be covered or both, as the case may be (usually voyage for cargo and time for hull insurances).

(4) The risks to be insured.

If the agreed valuation of the subject-matter insured is specified as such on the slip and policy, the latter is known as a *valued* policy. If not, it is known as an *unvalued* policy; and in the event of a claim arising under it, the value must be proved. In practice, all hull and cargo policies are invariably valued. The insured value for cargo normally includes the profit which the importing merchant anticipates making on the goods. Under an unvalued policy, this anticipated profit would not be recoverable from the insurers and, in the event of the goods being lost during the voyage, the merchant would merely be placed in the same financial position as if he had not embarked upon the adventure; whereas a valued policy places him, as nearly as possible, in the same position as if the transaction had been successfully completed.

His slip having been prepared, the broker presents it to an underwriter, who is recognised as being an expert in the class of business concerned, and the rate of premium is agreed. The premium is generally expressed as a rate per cent of the sum insured. The first underwriter accepting the risk is known as the *leading underwriter*, and he notes on the slip the share of the insurance that he will take; he signifies his acceptance by adding his initials.

As a rule, it is seldom that one underwriter will take a very large sum, or *line* as it is called, since it is desirable for the risks to be distributed as widely as possible. It is clear that it will be less risky for the underwriter to subscribe £1,000 on each of one hundred policies than £5,000 on each of twenty policies. Hence, the most frequent risks undertaken are for comparatively small sums, larger lines being subscribed only on extremely good risks.

The slip having been started, the broker proceeds to pass it to other underwriters. These, in turn, note the lines they will take and add their initials. This process goes on until the amount required is made up. It is common for both Lloyd's underwriters and companies to subscribe to the same slip. In fact, this is inevitable on large insurances, which test the capacity of the market. In the event of a claim arising, each underwriter pays such proportion of the total claim as the amount of his line bears to the total insured value.

It will be apparent that one of the functions of the broker is to assist in the spreading of the risk.

REINSURANCE.—An insurer who has accepted an insurance may reinsure either part or the whole of his liability with another insurer. An insurance company very often accepts the total risk in respect of business received direct from the assured and then spreads the risk throughout the market by way of reinsurance.

In the event of a claim, the original insurer is directly liable to the original assured for the full amount, and, on payment, proceeds to recover from the reinsurers their proportions. The original assured has no contract with the reinsurers and has no rights whatsoever against them.

A marine underwriter often finds that his customary limit in respect of any one vessel or location has been exceeded. He may have issued floating policies (see p. 563) or open covers[1] to a number of merchants, whereby he has undertaken to insure their future shipments, or he may have a number of underwriting agents in other markets and the business received from all these sources may result in an accumulation of risk on one vessel or in one location. To overcome this accumulation of risk, the underwriter may effect reinsurance on an excess of line or an excess of loss basis. Briefly, under an excess of line reinsurance, the original underwriter retains a specified line and reinsures the excess, and in the event of a claim arising, he recovers from the reinsurers such proportion of the settlement made by him as the amount reinsured bears to his total original line. Under an excess of loss reinsurance, the original underwriter bears any loss up to an agreed amount in any one vessel or location and recovers from the reinsurers any excess of that amount, up to an agreed limit.

Sometimes, an underwriter deliberately writes a larger line than he is willing to retain, with a view to reciprocal reinsurance, that is, the exchange of insurance business with another insurer, often in a foreign market, thereby securing business which would not otherwise be obtained. Reciprocal reinsurance has not played such a large part in the marine market in the past as it has in the non-marine market, because marine business has tended to gravitate direct to London without this inducement.

[1] These are not policies, but agreements between merchants (or shippers) and underwriters, whereby the former undertakes to declare and the latter to accept all shipments falling within the open cover during the period stipulated.

EXAMPLE OF A "HULL" INSURANCE.—Suppose it is desired to insure the s.s. *Cornubia* owned by Hamer & Co., of Cornwall.

The procedure followed in effecting the insurance of the vessel will briefly be as follows—

(1) The shipowners, Hamer & Co., approach Messrs. Ashton, Brown & Co., Ltd., Marine Insurance Brokers, and request them to submit a quotation for a twelve-months' policy (i.e. a time policy).

(2) The brokers interview the underwriters and get their lines written upon the slip (see specimen on page 558).

(3) The underwriters' quotation is dispatched to Hamer & Co. by the brokers.

(4) The terms being suitable, the shipowners instruct the broker to place the insurance.

(5) The insurance having been placed, the brokers forward a *Cover Note* to the shipowners. This cover note (see specimen on page 559) holds the shipowner covered until the policies are issued.

(6) The policies are issued and the brokers send the shipowners a *Debit Note* (i.e. a document similar to an invoice—see below).

ASHTON, BROWN & CO., LTD.

CORNHILL,

LONDON,........*6th January*, 19.......

Debit Note for insurance effected for account of

Messrs.............*Hamer & Co.,*..

...........................*Hayle*..

Vessel		Interest
........*Cornubia*	........12 *mos.* @ 1*st Jan. G.M.T*........	........*Hull and* ....
....	....	.... *Machinery*...

	£	s.	d
£100,000 @ 50*s*. %	2,500	-	-
STAMP	-	-	6
	£2,500	-	6

A. B. & Co., Ltd.

"Cornubia"

12 Mos. @ 1 Jany./19.. G.M.T.

Hull, Machy., etc.

Vd. £100,000

I.T.C.—Hulls and Inst. wts.

50/-

10.000 Comm. Un.
10.000 R. Ex.
20.000 Marine
10.000 U. of Canton
10.000 Indty
10.000 L. & P.
10.000 World
10.000 Morten
1.000 F. W. M.
5.000 Tyser
4.000 P. Janson

Opened........*23/12/*19........ No. ....

Closed ....*5/1/*19........ *£ 100.000*................

COVER NOTE

ASHTON BROWN & CO., LTD.
Insurance Brokers

Telegraphic Address
Ashton Stock, London

Telephone Nos.
576 Avenue
577 Avenue

Cornhill,
London....*2nd Jany.*,.... 19....
E.C.

Messrs. Hamer & Co.,
Hayle.

Dear Sir,

We beg to advise having effected the following Insurance on your account ....*£100,000*...

by the................*Cornubia*..

~~at and from~~........*12 Mos. @ 1 Jany., 19........G.M.T.*

~~to~~..

.... ~~including risk of craft~~

on........*Hull Machinery, etc.....vd..... £100,000.* ....

.... *Institute Time Clauses—Hulls and Institute....*

..........................*Warranties* ....

....*£ 100,000* at *50/-*........per cent. £...—...:...—...:...—...

Policy ...—...:...—...:...—...

£...—...:...—...:...—... .

U/rs as per slip

E. & O. E.

Ashton Brown & Co., Ltd.

........*F. Ashton*........
Director

THE POLICY—The wording of the marine policy has remained practically unchanged over the centuries. Although it has from time to time met adverse criticism in view of its antiquated phraseology, it is still kept in the same form, mainly because during years of litigation the meaning which the courts attach to almost every word has been clearly determined.

The standard form of marine policy as set out in the First Schedule to the Marine Insurance Act is inset. The details inserted in the blank spaces are—

(1) The name of the assured, or of some person who effects the insurance on his behalf.

(2) The words "their" or "his" as applicable.

(3) The words "themselves" or "himself" as applicable.

(4) The voyage or period of time covered, or both, as the case may be.

(5) The name of the vessel or other conveyance.

(6) This space, for the insertion of the name of the master, is nowadays invariably left blank.

(7), (8), and (9) The words "as above."

(10) The words "and wheresoever for all purposes" are often inserted here.

(11) The insured value and the subject-matter of the insurance.

(12) The rate of premium or, as is more usual in practice, merely the words "as agreed."

To meet modern requirements, the conditions of the policy are brought up to date by additional printed clauses. It is essential, in practice, when studying a policy to examine the clauses in conjunction with the policy, and not to study the policy alone, bearing in mind that where there is inconsistency the marginal clauses override the printed wording in the body of the policy; attached clauses override the printed wording in the body of the policy and the marginal clauses; and typewritten or written words prevail over all else, as they represent the immediate intention of the parties to the contract.

The letters "S.G." appear at the top of the policy and many different views have been expressed as to their original meaning. However, it is generally accepted that they represent "Ship-Goods," as the wording of the policy is suitable for both hull and cargo insurances. This opinion is confirmed by the fact that in an old

FORM OF POLICY

Lloyd's S.G. policy.

BE IT KNOWN THAT **(1)** as well in **(2)** own name as for and in the name and names of all and every other person or persons to whom the same doth, may, or shall appertain, in part or in all doth make assurance and cause **(3)**
and them, and every of them, to be insured lost or not lost, at and from **(4)**

Upon any kind of goods and merchandises, and also upon the body, tackle, apparel, ordnance, munition, artillery, boat, and other furniture, of and in the good ship or vessel called the **(5)**
whereof is master under God, for this present voyage, **(6)**
or whosoever else shall go for master in the said ship, or by whatsoever other name or names the said ship, or the master thereof, is or shall be named or called; beginning the adventure upon the said goods and merchandises from the loading thereof aboard the said ship, **(7)**

upon the said ship, &c. **(8)**

and so shall continue and endure, during her abode there, upon the said ship, &c. And further, until the said ship, with all her ordnance, tackle, apparel, &c., and goods and merchandises whatsoever shall be arrived at **(9)**

upon the said ship, &c., until she hath moored at anchor twenty-four hours in good safety; and upon the goods and merchandises until

policy on cargo dated 1708—preserved at Lloyd's—the letter "S" was omitted.

At the time of the Hanseatic League, there resided in London a number of wealthy bankers from Lombardy, who were engaged in banking, but also undertook the business of insurance. So great an impression did these Lombards make upon the commercial world that their memory is still commemorated by the characteristic words at the end of a marine policy—"This Policy of Assurance shall be of as much force and effect as the surest writing or policy of assurance heretofore made in Lombard Street, or in the Royal Exchange, or elsewhere in London."

The policy states that the subject-matter is insured "lost or not lost." This implies that the underwriters' liability to indemnify the assured, in the event of the subject-matter being lost, is retrospective to the commencement of the voyage or period of insurance, even if later it should be discovered that the loss occurred before the time of the contract being concluded, unless at such time the assured was aware of the loss and the insurer was not.

It is the duty of the assured and his agents to take such measures as may be reasonable for the purpose of averting or minimising a loss covered by the policy, and the underwriter, under the provisions of the *Sue and Labour Clause* contained in the body of the policy, agrees to pay his share of any charges incurred in this connection.

The *Waiver Clause*, which follows the *Sue and Labour Clause* in the policy, makes it clear that no acts of the insurer or assured in recovering, saving, or preserving the property insured shall be considered as a waiver or acceptance of abandonment. The object of this clause is to enable the parties to take any steps necessary for the preservation of the property without fear of prejudicing their rights.

The perils covered by the policy are—

> "of the seas, men of war, fire, enemies, pirates, rovers, thieves, jettisons, letters of mart and countermart, surprisals, takings at sea, arrests, restraints, and detainments of all kings, princes, and people, of what nation, condition, or quality soever, barratry of the master and mariners, and of all other perils, losses, and misfortunes, that have or shall come to the hurt, detriment, or damage of the said goods and merchandises, and ship, &c., or any part thereof."

The term "perils of the seas" refers only to fortuitous accidents or casualties of the seas. It does not include the ordinary action of the wind and waves; the policy provides indemnity against accidents which may happen, not against events which must happen.

The term "thieves" implies assailing thieves and does not cover clandestine theft or any pilferage committed by the crew or passengers.

The term "letters of mart and countermart" has no practical importance nowadays. Such letters were commissions granted by a Sovereign to make reprisals on an enemy's shipping.

The words "all other perils, losses, &c., . . ." are not so wide as they may at first appear. The Marine Insurance Act, 1906, makes it clear that they only include perils similar in kind to the perils specifically mentioned in the policy.

COMPARISON OF LLOYD'S POLICY AND COMPANY POLICY.— Broadly, there are three kinds of policies used in marine insurance, viz., those issued by—

(*a*) insurance companies,

(*b*) the Institute of London Underwriters, and

(*c*) Lloyd's.

An insurance company's policy is issued for direct or agency business; occasionally for broker's business, if only one company has underwritten the risk; and also for business underwritten by any companies who are not subscribers to the Institute of London Underwriters.

With the object of saving time and labour, a combined policy form scheme has been evolved, whereby one policy is issued by the I.L.U. on behalf of all the subscribing companies showing the sum insured by each company. The policy is signed by the Manager and Secretary of the I.L.U. and bears the seal of the Institute. This type of policy is generally used for business placed through insurance brokers.

A Lloyd's policy bears Lloyd's seal and is signed by the Manager of Lloyd's Policy Signing Office, on behalf of the underwriters concerned. A sheet is attached showing the names of all underwriters at Lloyd's, together with their syndicate numbers, and reference is made in the policy to the syndicate numbers of the underwriters subscribing to the insurance, showing the amount underwritten by them.

It is important to realise that, although only one combined policy is issued for all the Institute Companies, and another combined policy for all Lloyd's underwriters, the liability is not a joint and several one. Each insurer, whether Lloyd's or Company, is liable only for his own part and, accordingly, in the event of there being default on the part of one of the insurers (which is most unlikely), the assured will lose a corresponding proportion of any claim made under the policy. He will not get payment in full. That is a drawback from the point of view of the policyholder. But it is an arrangement under which he is no doubt able to get his risks covered on more favourable terms. If each of the various underwriters had to be responsible for any proportion of the risk accepted by his co-underwriters, at the very least he would want to charge, in addition to the normal premium, something further to cover the risk in the event of default on the part of the other underwriters. It would increase the cost of the policy, and make it exceedingly difficult to get policies for large sums carried through at all. All that the underwriter has now to consider is whether he cares to undertake the risk, and for how much. If he were liable for his co-underwriters, he would have to consider what their standing was and whether he cared virtually to guarantee them at all on any terms.

Notwithstanding the foregoing, the members of Lloyd's have voluntarily established a Central Guarantee Fund for the benefit of policyholders in the event of any member being unable to meet his underwriting debts.

CERTIFICATES OF INSURANCE.—In order to save the trouble and expense involved in issuing a separate policy for each shipment of cargo, a merchant engaged in regular overseas trade may take out a floating policy (sometimes called a declaration policy) expressed in general terms and for a substantial round sum, sufficient to cover a number of shipments. As each shipment goes forward, the details are declared to the underwriter and certificates of insurance are usually issued, certifying that the goods are insured under the policy. When the sum insured is exhausted, a fresh floating policy is issued.

GENERAL AVERAGE.—Suppose a ship has run aground in a position of peril and, in order to refloat, it is necessary to lighten the ship by jettisoning (i.e. throwing overboard) part of the cargo,

and, in consequence of this act, the ship and the remainder of the cargo are saved. It is only fair that the owners of the ship and cargo saved should contribute towards the loss of the cargo sacrificed for the common safety. This is one of the simplest and oldest examples of general average sacrifice. In practice, the jettison of deck cargo is not made good by the other interests unless it is the recognised custom of the trade to carry such cargo on deck.

If a tug is hired to assist in the refloating, the cost of hiring the tug represents general average expenditure, which is likewise recoverable from the parties concerned.

On the assumption, for the sake of simplicity of figures, that there has been no jettison, but that the shipowner has paid the sum of £1,000 for the hire of the tug—

	£
the arrived value of the ship being	100,000;
the freight at the risk of and earned by the shipowner being	10,000;
and the arrived value of the cargo being . .	90,000;
the total contributory value would be . . .	£200,000

The expense would be borne as follows—

		£
G.A. contribution of ship $\frac{1}{2}$ of £1,000	=	500
,, ,, freight $\frac{1}{20}$ of £1,000	=	50
,, ,, cargo $\frac{9}{20}$ of £1,000	=	450
		£1,000

then the shipowner would recover £450 from the cargo interests.

It was mentioned on p. 551 that freight which has been prepaid absolutely is not at the risk of the shipowner and becomes merged in the value of the cargo. If, therefore, in the above example freight had been prepaid absolutely, it would not contribute as a separate entity but would enhance the contributory value of the cargo.

The contribution is made upon the actual net values of the property at the termination of the adventure, to which values are added the amounts allowed (made good) in general average in

respect of interests sacrificed. It is a matter of equity that the "made good" should be brought in to contribute; otherwise, the owners of the property sacrificed, having had their losses made good in full, would be in a relatively better position than the owners of the remainder of the property who have contributed toward making good the sacrifice.

Other examples of general average losses are as follows—

(*a*) Damage caused by water used in extinguishing fire.

(*b*) Damage to the vessel's machinery whilst being worked in attempting to force the vessel off a strand.

(*c*) Damage to cargo caused by water entering a hold when a jettison is being made.

(*d*) Cargo or ship's materials burnt as fuel, but only if the quantity of fuel originally provided would in normal circumstances have been adequate.

(*e*) Expenses, such as the cost of hiring barges, etc., incurred in discharging cargo to lighten a vessel to get her off a strand.

(*f*) Expenses of putting into a port of refuge.

In order to be allowed as general average, sacrifices or expenditure must have been incurred—

(1) voluntarily and intentionally;

(2) reasonably and prudently;

(3) for the avoidance of a real danger to the common adventure (sacrifices or expenses made under the mistaken idea that a peril existed would not be allowed);

(4) with the object of preserving the whole adventure (expenses incurred for the benefit of individual interests not being allowed);

(5) in an extraordinary manner;

(6) as a direct consequence of the general average act;

(7) without default on the part of the person whose interest has been sacrificed or who has incurred the expenditure.

With a view to achieving international uniformity in the adjustment of general average, a set of rules known as the York-Antwerp Rules have been drawn up, and contracts of affreightment almost invariably provide for general average to be adjusted in accordance with these Rules.

When the ship arrives at destination, the shipowner is responsible for ensuring that adequate security is obtained for the payment of the general average. He has a maritime lien on the cargo; that is to

say, he need not hand the cargo over to the consignees until security has been obtained.

The general average statement is drawn up by an average adjuster, a specialist qualified by training and experience. This statement or adjustment may take some time to prepare and the shipowner, before releasing the cargo, is entitled to collect by way of security general average deposits based on estimates. Shipowners also generally require consignees' signature to an average bond. On completion of the adjustment, the final figures are usually found to be slightly less than the estimates, and the credit balance relating to each interest is repayable to the holders of the deposit receipts.

Instead of collecting deposits, shipowners are often prepared to accept guarantees from the insurers of the cargo.

SALVAGE CHARGES.—A salvage award is granted according to maritime law to a successful salvor who, voluntarily and independently of any contract, has been instrumental in saving marine property or life at sea. The salvage award is apportioned over the values of the various interests saved in much the same way as general average.

If a contract to save property has been entered into, the remuneration payable does not fall under the heading of salvage charges, but is dealt with as general average or sue and labour charges as circumstances may warrant.

If a vessel should be in distress and it is necessary to seek salvage assistance, the master usually does his best to get Lloyd's Standard Form of Salvage Agreement adopted. This form is on a "no cure—no pay" basis and so preserves the essential features of maritime salvage, leaving the amount of remuneration, in the event of dispute, to be determined by arbitration. In this way much costly litigation is avoided.

APPLICATION OF GENERAL AVERAGE AND SALVAGE TO INSURANCE.—Both general average and salvage are based on maritime law and exist entirely independently of marine insurance. The origin of general average is lost in antiquity, but the practice is known to have existed in the Mediterranean about 700 B.C.

Although they exist independently of marine insurance, general average and salvage charges are recoverable under the policy when incurred for the purpose of preventing a loss by perils insured against.

If the assured's property is sacrificed, he may recover directly from the insurers in respect of the loss without having first enforced his right of contribution from the other parties. However, if the assured has incurred general average expenditure, he may recover from the insurers only the proportion which falls upon him. Where there is under-insurance, the insurers' liability for general average contribution and salvage charges is rateably reduced.

PARTICULAR AVERAGE.—A particular average loss is defined by the Marine Insurance Act, 1906, as "a partial loss of the subject-matter insured, caused by a peril insured against, and which is not a general average loss." The term "loss" in this sense implies, not only property actually lost, but also the pecuniary loss involved in connection with property which has been damaged.

The main distinctions between general average and particular average may be summarised as follows—

(*a*) General average is voluntarily incurred for the safety of the joint adventure, whereas particular average is, broadly, due to accidental causes, such as fire, heavy weather, stranding, etc.;

(*b*) General average is contributed to by the owners of the property saved, whereas particular average is said to "lie where it falls."

In the event of goods being received at destination in a damaged condition, they are surveyed as quickly as possible by some competent and disinterested person, who certifies as to their damaged condition, and gives the cause of the damage as far as it can be ascertained. The surveyor endeavours to agree with the consignees an allowance to cover the loss, usually expressed as a percentage of the value of the goods. Failing agreement, the goods may be sold for the best offer obtainable, and the extent of the depreciation, ascertained by comparing the amount actually realised with the sound market value, is then applied to the insured value.

If the goods which are lost or damaged form part of a larger consignment covered by a single insured value, it is necessary to apportion this value. This is a simple operation if the goods are all of equal value, e.g.—

1,000 articles—insured value £600.

88 articles damaged—insured value in proportion

$$\frac{£600 \times 88}{1{,}000} = £52\ 16s.$$

However, if different types or qualities of goods are insured under one value, this value may usually be apportioned on the basis of the invoice prices, e.g.—

1,000 articles—insured value £600.

		£
750 articles type "A"—invoice price 10s. each	.	375
250 „ „ "B"— „ „ 14s. „	.	175
1,000 Total invoice price	.	£550

88 type "A" damaged @ invoice price 10s. each = £44.

If the total invoice price of £550 is insured for £600, invoice price of damaged goods £44 will be insured in proportion for

$$\frac{£600 \times 44}{550} = £48.$$

In making a calculation of this kind it is important to compare "like with like." It would obviously be incorrect to base the calculation on a comparison between, say, the net invoice value of the damaged articles and the total C.I.F. value of the consignment including the insurance premium and freight.

On the assumption in the second example above that the articles were seawater damaged and were sold at destination in order to ascertain the extent of the loss, the proceeds of sale being—

	£
88 articles type "A" sold for	33
Less sale charges . .	2
Net proceeds .	£31

and the sound market value of type "A" articles on the day of sale being 12s. 6d. each, the claim under the policy would be adjusted as follows—

	£
Sound value 88 type "A" @ 12s. 6d. . .	55
Realised gross	33
Loss	£22

If sound value £55 loses £22, insured value £48 will lose in proportion—

	£	s.	d.
$\frac{£48 \times 22}{55} =$	19	4	–
Sale charges . .	2	–	–
Survey fee . .	3	3	–
	£24	7	–

Merchants are occasionally under the erroneous impression that if their goods arrive at destination damaged by a peril insured against, the underwriters should pay the difference between the insured value and the net proceeds of sale. Such a settlement would involve the underwriters in a rise or fall of the market for the commodity concerned. The principle, long ago established in the courts, and which has since received statutory effect by the Marine Insurance Act, 1906, is that where the whole or any part of the goods insured has been delivered damaged at its destination, the measure of indemnity is such proportion of the insured value as the difference between the gross sound and damaged values at the place of arrival bears to the gross sound value. By this method, underwriters' liability should not be affected by market fluctuations, as the price for damaged goods will rise and fall in sympathy with fluctuations in the price obtainable for sound goods. It will be noticed that the preceding example is in accordance with this principle.

Certain commodities normally lose or gain volume or weight during transit. For example, volatile liquids may evaporate, wine may seep into the wooden casks, wool may lose some of its moisture content by drying out or, conversely, it may absorb more moisture if passing through a humid climate; and nuts and seeds also tend to lose weight. In the adjustment of claims for shortage resulting from insured perils, it is essential to take this ordinary loss or gain into account.

It is sometimes necessary with such commodities as wool, cotton or tobacco to make allowance for increase in weight by reason of water damage.

Particular average claims under hull policies are usually in respect of the cost of repairs, including various incidental expenses, such as dry dock dues, etc. The measure of indemnity is the reasonable cost of the repairs, up to the limit of the sum insured for any one casualty, without regard to any difference which may exist between the actual value of the vessel and the value expressed in the policy. As a rule, the statements are prepared by average adjusters, and the adjustment fees are added to the amount of the claim. Very often the particular average claim on ship and the general average adjustment are included in the one statement.

THE MEMORANDUM.—At the foot of the policy form appears what is known as the memorandum which reads as follows—

> "N.B.—Corn, Fish, Salt, Fruit, Flour, and Seed are warranted free from Average, unless general, or the Ship be stranded; Sugar, Tobacco, Hemp, Flax, Hides, and Skins are warranted free from Average under Five Pounds per Cent; and all other Goods, also the Ship and Freight, are warranted free from Average under Three Pounds per Cent, unless general, or the Ship be stranded."

This was added to the policy in the eighteenth century following experience by underwriters of numerous trivial claims, the expense of settling which was often greater than the claims themselves, and also by reason of claims on certain commodities especially susceptible to damage caused by insured perils.

The effect of the memorandum is that particular average is not payable by underwriters on certain commodities, and is payable on the ship, freight and other commodities only if it reaches the stipulated percentage. However, if the ship strands during the voyage, the whole effect of the memorandum is vitiated, whether or not the loss or damage results from the stranding, provided, as regards cargo, that it was on board at the time of the stranding. This may appear illogical, but it avoids disputes which may arise as to the exact time or cause of damage occurring during the voyage.

If the stipulated percentage is reached, the full amount is payable and not merely the amount in excess of this percentage. On the assumption, for example, that the insured value of a shipment of sugar is £100, particular average amounting to £4 would not be payable, unless the ship had stranded. However, if the particular average were £20 the insurers would pay the full £20 (and not merely £15 being the amount in excess of £5, i.e. 5 per cent of

£100). Similarly, if the particular average were £5, they would pay the sum of £5.

The stipulated percentage is generally referred to as the *franchise.* In order to test whether or not the franchise has been attained, only particular average may be taken into account. General average, particular charges, such as charges recoverable under the *Sue and Labour Clause,* and extra charges incurred in consequence of the damage, such as survey fees, etc., may not be added to particular average in order to attain the franchise.

The exact terms of the memorandum are to a certain extent nowadays over-ridden by the clauses attached to the policy to meet modern requirements. However, it is essential to understand the application of the memorandum, because it forms the basis of the average provisions of these clauses.

INSTITUTE CLAUSES.—One of the functions of the Institute of London Underwriters is the drafting and revision of standard marine clauses. This work is carried out in close collaboration with the other organisations concerned in the marine insurance market, since these clauses are used by the whole market.

It is impracticable in a book of this type to deal with all the clauses which have been framed or sanctioned by the Institute, and it is proposed to consider a few of the main cargo clauses only in general use. (There are also clauses in use for hull and freight insurances.)

Cargo. The conditions on which cargo is generally insured may be—

(*a*) F.P.A. (Free of particular average);

(*b*) W.A. (With average); or

(*c*) A.R. (All risks).

The term "with average" refers only to the perils listed in the body of the policy.

The conditions are agreed upon at the time the insurance is effected. The factors determining the choice of the conditions are based largely upon: the scope of cover required by the merchant, and the amount he is prepared to pay for that cover; the cover which the underwriter is prepared to grant, and the rate of premium required by him; the custom of the particular trade in question; any special provision in the contract of sale requiring the goods to be insured on certain conditions; and the susceptibility of the goods

to various kinds of damage. The wider the conditions of cover, the higher will be the rate of premium charged.

There is an appropriate set of Institute Cargo Clauses for general use for each of the above three types of cover. For certain commodities there are what are known as Trade Clauses, the conditions of which are especially suited to the insurance of such commodities.

In view of the differing circumstances which may be involved in cargo insurances, special variations of the above conditions may be used, and this is frequently achieved by special typewritten wording being inserted in the policy. It is common to find certain extraneous risks, such as breakage, freshwater damage, theft, pilferage, non-delivery, etc., specially added to F.P.A. or W.A. cover, or, alternatively, goods may be insured on such conditions as "Institute Cargo Clauses (All Risks), but excluding breakage."

A copy of the Institute Cargo Clauses (W.A.), current at the time of going to press, is inset by kind permission of the Institute of London Underwriters and Witherby & Co., Ltd., and it is recommended that this document be carefully studied, particularly the average clause (No. 6), which should be contrasted with the memorandum.

"The percentage specified in the policy" refers to the memorandum percentage, unless by special provision in the policy it is agreed that some alternative percentage shall be applicable. Average is payable irrespective of percentage if the vessel or craft be stranded, sunk, or burnt during the voyage, whether or not the damage be caused by the stranding, etc., in the same way as in the memorandum. Average is also payable irrespective of percentage for loss or damage attributable to fire, etc.

The Institute Cargo Clauses (W.A.) considerably extend the cover which would be afforded by the plain form of policy without the attachment of the clauses, but the risks covered are only those mentioned in the policy or the clauses.

The Institute F.P.A. and All Risks clauses are substantially the same as the W.A. clauses with the exception of the average clauses, which read respectively as follows—

F.P.A.

6. Warranted free from Particular Average unless the vessel or craft be stranded, sunk, or burnt, but notwithstanding this warranty the Underwriters are to pay the insured value of any package or packages which may be totally lost in loading, transhipment or discharge, also for any

INSTITUTE CARGO CLAUSES (W.A.)

Warehouse to Warehouse Clause.

1. This insurance attaches from the time the goods leave the warehouse at the place named in the policy for the commencement of the transit and continues until the goods are delivered to the Consignees' or other final warehouse at the destination named in the policy. In no case however shall the period of cover after completion of discharge overside of the goods from the oversea vessel at the final port of discharge extend beyond 60 days.

Extended Cover Clause.

2. Subject to the provisions of the foregoing Clause and of Clause 3 hereunder this insurance shall remain in force during

(i) deviation, delay beyond the control of the Assured, forced discharge, re-shipment and transhipment

(ii) any other variation of the adventure arising from the exercise of a liberty granted to shipowners or charterers under the contract of affreightment.

but shall in no case be deemed to extend to cover loss damage or expense proximately caused by delay or inherent vice or nature of the subject matter insured.

Termination of Adventure Clause.

3. (a) If owing to circumstances beyond the control of the Assured either the contract of affreightment is terminated at a port or place other than the destination named therein or the adventure is otherwise terminated before delivery of the goods into Consignees' or other final warehouse at the destination named in the policy, then, provided notice is given immediately after receipt of advices and subject to an additional premium if required, this insurance shall remain in force

(i) until the goods are sold and delivered at such port or place

or (ii) if the goods are forwarded to the destination named in the policy or to any other destination, until the goods have arrived at Consignees' or other final warehouse at such destination,

subject however in either case to the limitation of period after discharge as provided for in Clause 1 above.

(*b*) Notwithstanding the provisions of the foregoing Clauses, if the goods are sold (the sale not being one within the provisions of Clause 3 (a))

whilst the insurance is still in force

and

before expiry of 15 days from midnight of the day on which the goods are discharged overside from the oversea vessel at the final port of discharge,

and following the sale the goods are to be forwarded to a destination other than that to which they are insured by this policy, this insurance shall remain in force

until the expiry of the said period of 15 days at the final port of discharge

or

until the goods commence transit at that port at the risk of the buyers,

whichever first occurs.

If such sale takes place after expiry of the aforementioned period of 15 days but while this insurance is still in force the insurance shall cease as from the time of sale.

Craft, &c. Clause.

4. Including transit by craft, raft and/or lighter to and from the vessel. Each craft, raft or lighter to be deemed a separate insurance. The Assured are not to be prejudiced by any agreement exempting lightermen from liability.

Change of Voyage Clause.

5. Held covered at a premium to be arranged in case of change of voyage or of any omission or error in the description of the interest vessel or voyage.

Average Clause.

6. Warranted free from average under the percentage specified in the policy, unless general, or the vessel or craft be stranded, sunk or burnt, but notwithstanding this warranty the Underwriters are to pay the insured value of any package which may be totally lost in loading, transhipment or

loss of or damage to the interest insured which may reasonably be attributed to fire, explosion, collision or contact of the vessel and/or craft and/or conveyance with any external substance (ice included) other than water, or to discharge of cargo at a port of distress, also to pay special charges for landing warehousing and forwarding if incurred at an intermediate port of call or refuge, for which Underwriters would be liable under the standard form of English Marine Policy with the Institute Cargo Clauses (W.A.) attached.

This Clause shall operate during the whole period covered by the policy.

All Risks

6. This insurance is against all risks of loss of or damage to the subject-matter insured but shall in no case be deemed to extend to cover loss damage or expense proximately caused by delay or inherent vice or nature of the subject-matter insured. Claims recoverable hereunder shall be payable irrespective of percentage.

The reference in the F.P.A. clauses to landing, warehousing and forwarding charges is a concession to the assured and avoids any disputes which may arise as to whether they were incurred to avert a total or a partial loss.

The All Risks clauses do not cover all loss or damage but all *risks* of loss or damage. The loss must result from some fortuity or accident: inevitable losses or expenses are not covered.

WAR RISKS.—War risks are excluded from the policy by the F.C. & S. Clause (free of capture and seizure). If war risks are to be covered, the F.C. & S. Clause is generally deleted and the appropriate Institute War Clauses attached to the policy.

Under the terms of the Waterborne Agreement, war risks on land, except with a few limited exceptions, are not covered by underwriters, thereby bringing marine insurance into line, as far as possible, with fire and accident insurance practice.

British hulls are usually insured against war risks with the P. & I. Association in which they are entered.

CONCLUSION.—With the changed commercial customs of our own days, marine insurance is just as essential as ever in fostering overseas trade. Vast amounts of capital are exposed to loss in modern ships, and few shipowners would be willing, or able, to set up sufficient reserve funds to make adequate provision for major casualties to their vessels. Merchants are able to trade more freely and widely with the protection afforded by marine insurance. A merchant, particularly one with comparatively small resources, would be unwilling to accept the risk involved in investing his capital in a shipment to be exposed to the numerous and very real

perils encountered in a maritime adventure. Indeed, modern methods of financing overseas trade would be impossible without the collateral security afforded by a marine insurance policy.

TEST PAPER

1. Define marine insurance.
2. What are the three chief forms of insurable interest in a marine adventure?
3. Distinguish between the Insurance Companies and Lloyd's.
4. Describe how a marine insurance risk may be placed in the London market.
5. What is reinsurance and why is it necessary?
6. Explain how a policy, which contains written or typed wording and has clauses attached, is construed.
7. Give the meaning of the following terms which appear in the printed wording of a marine insurance policy—
   (*a*) Perils of the seas; (*c*) Jettisons;
   (*b*) Thieves; (*d*) All other perils.
8. Summarise the main distinctions between general average and particular average, and enumerate five examples of general average losses.
9. Name three forms of conditions of cover for cargo insurances.
10. From the following particulars, adjust the claims for particular average—
   (*a*) Sound value of goods £330; (*c*) Insured value £340;
   (*b*) Gross value in damaged condition £209; (*d*) Survey fee £5.
11. Describe briefly the purpose of—
   (*a*) The Marine Insurance Act, 1906; (*c*) The Waterborne Agreement.
   (*b*) The York-Antwerp Rules;

CHAPTER LII

INSURANCE (II)

OTHER FORMS OF INSURANCE

FIRE INSURANCE.—The gilds of Anglo-Saxon and later times often provided relief when their members suffered loss or damage by fire, but fire insurance as a commercial contract began in 1680 when a scheme was devised by a speculative builder. Other schemes were soon formulated, and the *Hand-in-Hand* and the *Sun Fire Office*, which are still transacting business, commenced in 1696 and 1710 respectively.

Buildings are insured against fire risks, and also stock-in-trade, fixtures, fittings, plant and machinery, as well as household goods and personal effects in private use. Private dwellings and their contents, however, are now usually insured under house-owners' and householders' comprehensive policies, as explained later.

Premiums for fire insurance are calculated at rates per cent on the sum insured. Rates depend on a number of factors, such as the construction of the external walls and roof, the trade carried on, lighting, heating, and any other special fire risks involved. Rating reductions are made in consideration of the installation of fire-extinguishing appliances, sprinklers, drenchers and other precautions designed to improve the risk.

Special Perils. In recent years fire insurers have offered cover against loss or damage through the happening of various special or extra perils, such as riot and civil commotion, storm, tempest and flood, bursting or overflowing of water tanks, apparatus and pipes, impact by road vehicles, horses or cattle, and aircraft and other aerial devices or articles dropped therefrom.

Sundry special perils are covered under comprehensive policies for private dwelling risks, and this has stimulated a demand for similar protection for business premises. In a severe winter many thousands of storm and burst pipes claims are dealt with, and they can prove to be very expensive to insurers.

Consequential Loss. This class of cover is also known as profits or loss of profits insurance and it is designed to cover loss of *revenue* consequent upon the interruption of the business by fire (or any

other peril insured against). It is therefore complementary to fire insurance which covers *capital* loss. No business man is adequately insured without both classes of policy, for it is useless to rebuild and to secure fresh stock and equipment if customers have gone elsewhere during the period of reconstruction, particularly when a lengthy period is involved.

A policy of this type insures loss of net profit and standing charges (e.g. interest on debentures, salaries to permanent staff) which continue to be payable despite reduction in turnover, and also the increased cost of working during the period of interruption. It may be necessary to rent temporary premises and to have goods made elsewhere, and, since the extra cost will in the terms of the policy be paid by the insurers, everything possible can be done to minimise the reduction in trade by reason of the dislocation caused by fire or any other insured peril.

Sprinkler Leakage. Under this heading cover is provided if damage is caused by water accidentally discharged by leaking from a sprinkler installation, subject to certain exceptions.

Householders' Comprehensive Insurance. Insurers offer either through the fire or the accident departments house-owners' and householders' comprehensive policies on the buildings and contents of private dwellings. These provide much wider cover than is obtainable under a number of separate policies at low rates of premium. It is a condition that the sums insured shall represent full value in order that insurers may secure an adequate premium.

Reinsurance. Very large sums insured—sometimes running into millions of pounds sterling—are dealt with in the fire department; hence, reinsurance is essential. The favoured method of reinsurance is by means of treaties, but if the treaties cannot absorb the amounts that the insurer wishes to place, then facultative reinsurance is sought for the balance.

Important Service to the Community. In addition to the provision of compensation for those policyholders who suffer loss or damage by the operation of insured perils, fire insurers perform many valuable services. They play an important part in the reduction of fire waste. By their systems of rating they penalise bad features and reward (by lower rates and discounts, e.g. for fire-extinguishing appliances) favourable features. Salvage Corps are operated by fire insurers in Glasgow, Liverpool, and London, and the Corps

work in co-operation with the fire brigade in order to minimise fire losses. The Fire Offices' Committee Fire Protection Association endeavours to educate the public in fire prevention, in the knowledge that the majority of fires are caused by carelessness or ignorance. The Fire Offices' Committee (a central association of the principal fire insurers) and the Department of Scientific and Industrial Research are partners in the Joint Fire Research Organisation, which carries out various tests in order to reduce fire waste.

LIFE ASSURANCE.—The two main functions of life assurance are to provide protection for dependants and to afford a profitable means of investment. Life assurance encourages saving, and the Government recognises the importance of life assurance by granting income-tax relief on premiums paid.

The business is divided into ordinary life assurance and industrial life assurance. The earliest life policy that has been traced is dated 1583, but all the early contracts were for short periods. The business could not be developed on modern lines until the growth of actuarial science. Industrial life assurance arose out of the Friendly Societies and was a development of the nineteenth century.

Life assurance premiums are actuarially calculated on the basis of mortality tables at level premiums payable throughout the duration of the contract and graduated according to age at entry. If the sum assured on a life is very high, reassurance will be sought, but under the large majority of policies this is unnecessary.

ORDINARY LIFE ASSURANCE.—The main types of life assurance are as follows—

Term. A term policy is effected for a specified period, for example, five years. If the assured survives the term, the contract ceases, and, naturally, there is no claim payable. A variation of this is the decreasing term contract, whereby the sum assured decreases annually; such a policy may be effected to cover a loan which is repayable over a period. There is also the convertible term assurance, which likewise lapses at the end of the term unless the assured has exercised an option during a specified part of the term to convert to a whole life or endowment assurance. During the term the premium is lower than under an ordinary assurance, and this may appeal to a young man who can convert when his income increases.

Whole Life. This is the ideal type of policy for the married man,

since he obtains the maximum life cover for the premium paid. Premiums are payable throughout life and the sum assured is payable at death. A modification of this kind of contract is a whole life assurance with limited payments so that premiums cease to be payable at age 60 or 65, when retirement entails a reduction of income.

Endowment. Under an endowment assurance there is a fixed term, say 10, 15, 25, or more years, during which the premiums are payable, and the sum assured is due at the expiry of the term or at previous death. This kind of policy is very popular, and it may be used to increase or provide a pension by the investment of the policy proceeds at interest on maturity. Sometimes, the policy contains the option at maturity to accept payment of an annuity (instead of the lump sum) on and from the expiry of the fixed term until death.

Family Income. Various names are given to this kind of protection, the essential feature of which is the provision of an income as well as of a capital sum. A married man who has children to educate may arrange to effect such a policy, under which a fixed sum will be paid per annum if he dies, say, at any time during the next 20 years. In this way his widow will receive an income from the date of death to the end of the remainder of the term and also a lump sum at death or at the end of the term, or at both.

House Purchase. If a person buys a house and secures a mortgage to do so, repayments will normally have to continue until the loan has been repaid, despite the death in the meantime of the borrower. Under a house purchase scheme a decreasing term assurance is effected so that if death occurs before the mortgage has been redeemed, the sum assured will be payable to extinguish the amount outstanding at the date of death. If the mortgage is not a reducing one, then an endowment assurance may similarly be effected to protect the borrower's estate, since the sum assured will be payable on maturity or earlier death to extinguish the amount owing.

Educational Schemes. An endowment assurance may be effected on the parent's life for a sum assured payable in instalments over a child's schooling period. Alternatively, educational provision may be made by a succession of endowments maturing at intervals.

Child's Deferred. A policy may be effected at birth or in the early years of a child's life, and during the period of deferment, i.e. until

the child attains 21 or 25 years, there is no assurance cover on the child's life. At the end of the period of deferment, however, a cash sum may be collected or a whole life or an endowment assurance may be secured for a substantial sum, regardless of the state of health of the child at the time. The parent has, so to speak, "subsidised" the contract during the period of deferment, and the child secures life assurance at a much lower premium than would be payable if a new contract were effected at the "vesting age." Frequently, the policy is effected for the cash sum on the parent's life during the deferment period.

Group Life and Group Pension. Group life assurance, say for one or two years' salary, can be effected to embrace all the employees of a firm or all those in specified categories during service. A slightly lower premium is charged than for individual policies. Group pension schemes are also available, and they are popular in these days when provision for pensions is very much to the fore.

General Features. Life assurance may be arranged on a with-profit or without-profit basis. Under the former the policyholder shares in the investment success of the company, and, on the whole, with-profit policies are preferred by the assuring public to without-profit contracts.

Life assurance can be used for various special purposes—

(*a*) A creditor may assure the life of his debtor because of the indebtedness so that in the event of the death of the latter he will be recouped.

(*b*) When a partner dies the partnership comes to an end, and it may be expensive to pay into the deceased partner's estate the amount of his interest. This can be overcome by partners effecting life assurance cover.

(*c*) A man may wish to borrow money, and, if so, a life assurance policy may provide security for the loan.

(*d*) In these days of heavy death duties policies may be effected to offset this burden on the estate. The policy moneys can be paid direct to the Estate Duty Office, which saves interest running on the duties. The proceeds of the policy are, of course, aggregable for duty purposes.

(*e*) Under the Married Women's Property Acts a woman can have a separate estate, and policies may be effected under the Acts for this purpose. To-day, however, the main attraction of such policies

is the death duty concession, since the proceeds in certain circumstances are not aggregable, as far as the deceased is concerned, for duty purposes.

Life assurance may be arranged under a medical or a non-medical scheme. Many people do not wish to be medically examined, and, provided the proposal form is satisfactory, it is possible to assure within limits without an examination. Even under a non-medical scheme the office reserves the right to have an examination and will exercise that right if any of the answers given by the proposer put them on inquiry.

INDUSTRIAL LIFE ASSURANCE.—The fundamental principles are identical with those of ordinary life assurance. The main differences are that industrial assurance premiums are collected (by industrial assurance agents) at the homes of the policyholders frequently throughout the year, the sums assured are usually lower than those under ordinary life policies, and the classes of policy are comparatively few, mainly whole life, endowment, and recurring endowment, i.e. an endowment assurance with payment of a cash benefit at the end of every 5, 7, or 10 years. The option is given to convert this cash sum to additional sum assured.

Industrial assurance policyholders benefit from profits, but there is no division into with-profit and without-profit contracts as in ordinary life assurance.

ANNUITIES.—Life offices transact annuity business. This is not life assurance, but since it is part of their business it is convenient to deal with annuities here. A lump sum can be paid to the company, in return for which an annuity will thenceforth be payable usually every six months until the death of the annuitant. This is termed an immediate annuity. Alternatively, an amount may be paid each year to the company for a specified term for a deferred annuity, which is payable from the expiry of the term of deferment until death. Annuities can be bought in joint names, and among other types there is a reversionary annuity, which becomes payable if the annuitant survives the death of another.

Annuity rates are dependent on age at entry and on the type of contract required.

ACCIDENT INSURANCE.—This is a comparatively recent development. Personal accident insurance, which gave the branch its name, began in 1849, but the branch now includes fidelity guarantee,

which started a little earlier in 1840, and all classes of insurance for which provision is not made by the marine, fire, and life departments. The Employers' Liability Act, 1880, accelerated development because that statute created new liabilities on the part of employers for accidents to their employees. Still further development followed with the passing of the Workmen's Compensation Act, 1897, which introduced the principle of payment of compensation for incapacity by occupational accidents irrespective of negligence, while the Act of 1906 extended to practically all those under a contract of service, including domestic servants. Another major section of accident insurance arose towards the end of the nineteenth century with the invention of the mechanically-propelled road vehicle, and the Road Traffic Act, 1930, introduced compulsory motor insurance.

There are six main classes of accident insurance—namely, personal accident, fidelity guarantee, public liability, employers' liability, motor, and burglary. The accident department, however, includes a number of miscellaneous classes of cover such as glass breakage, the insurance of livestock against death by accident or disease, and various special contingencies, for example, lost documents, missing beneficiaries, and forged transfers. Engineering and aviation are technically accident insurance, but they are so specialised as to be regarded as separate.

Personal Accident. A capital sum is insured in the event of death or loss of limbs or eyesight by accident, and weekly compensation for temporary total or partial disablement. Weekly benefits can also be insured in respect of sickness. The benefits vary within limits with different insurers, and special prospectuses are issued by some offices designed to appeal to particular classes of the community. There are annual contracts and also so-called "permanent" contracts which cannot be cancelled by the insurers until a specified age, so long as the premiums are paid and the policy conditions observed. Policies can be effected by individuals, but there are also group schemes available for the employees of firms or for members of clubs and other associations.

The business began with the increase in accidents by reason of the building of railways, and to-day it has been stimulated by another form of travel, namely, air travel. Firms frequently insure their employees while they are travelling by air on business trips, and

cover is also sought by holidaymakers, either for specified flights or for the entire holiday period. It is even possible to secure cover from slot machines on airfields.

Fidelity Guarantee. Commercial fidelity guarantees protect employers from loss of moneys (and sometimes stock as well) through the dishonesty of members of their staff. Policies can be secured in respect of individuals, or collective or floating policies may be effected to include many or all of the staff. Under a collective policy there is a separate amount guaranteed in respect of each named person, but under a floating contract there is one amount of guarantee only. Guarantees in respect of local government officers are dealt with separately because the protection extends beyond loss through dishonesty to loss by reason of mistakes. Court and government bonds are entered into where persons are appointed by the court or by government departments to positions of trust, such as administrators of the estates of deceased persons and trustees in bankruptcy. Government bonds also include those required by H.M. Customs and Excise to protect the Revenue Authorities against loss through default in payment of duty on dutiable goods.

Public Liability. An indemnity is provided in respect of liability at law for death of or bodily injury to members of the public or for damage to their property happening in the circumstances set out in the contract. There is a limit of liability for any one occurrence and sometimes for any one year.

Within this section there are several sub-sections. The public liability (general) policy applies where no special form is applicable. Separate forms are used, for example, for estate owners' and farmers' indemnities, for passenger lifts (including periodical inspections), and for the so-called personal liability contract which protects the private individual against claims in respect of his liability to the public as a pedestrian and in other ways not connected with any business or profession or the ownership or occupation of land or buildings. Goods sold or supplied may give rise to claims for death or illness or bodily injury, and products liabilities may be insured as an extension of the general indemnity or under a separate policy.

Professional indemnities are in a class by themselves. They protect professional men against claims arising out of neglect, omission, or error in the exercise of their profession, whereby clients are caused financial loss.

Employers' Liability. Before 5th July, 1948, when the extended National Insurance Scheme came into force, an employers' liability policy protected an employer against his liability at law for death of or bodily injury to his employees, where the accident arose out of and in the course of the employment, under the Workmen's Compensation Acts, the Employers' Liability Act, 1880, or at Common Law. The Acts named were repealed from the date named and an employers' liability policy thenceforth insured the remaining liability.

To-day, many claims are made against employers at Common Law, and claims may be based on breach of statutory duty. If an employer neglects to fence dangerous machinery, as required by the Factories Acts, 1937–59, he will, as a rule, be liable for any injury sustained by his employee without proof of negligence.

An employers' liability policy before 5th July, 1948, included liability for certain scheduled diseases, and liability for disease is still included. Normally, it is necessary to prove that the employer has been negligent; one employee recovered damages because he caught pneumonia through working in a draught. In certain industries claims occur by reason of pneumoconiosis, which is a pulmonary disease contracted, for instance, by contact with harmful dusts.

Motor Insurance. This is the largest class of accident business in terms of premium income, and it is by no means easy to avoid a loss, let alone to make a profit, because of the many road accidents which occur. Liability for death of or bodily injury to third parties where such death or injury occurs on the public highway must be insured because of the provisions of the Road Traffic Act, 1960 (unless certain alternative requirements are complied with), but the wise motorist has at least full third-party cover which includes also liability for damage to third-party property. Unless the vehicle is very old, the much wider cover of a comprehensive policy is desirable.

This is a complex class of business, with many problems. Different policy forms are used for private cars, commercial vehicles, motor trade vehicles, motor cycles, agricultural and forestry vehicles, and vehicles of special types, such as bulldozers, dumpers and other vehicles used as tools of trade.

All policies issued in respect of vehicles used on the road must

comply with the requirements of the Road Traffic Act. Insurers accept liability for hospital charges and also for emergency treatment payments, for which provision is made under the Act. The Act requires a certificate of insurance to be issued for each vehicle, and when a new insurance is arranged it is usually necessary to issue a temporary cover note, which must be in special form and must incorporate a certificate of insurance.

Burglary Insurance. This class of insurance is concerned with loss or damage by reason of breaches of the criminal law, and the principal crimes concerned are burglary, housebreaking, and larceny. Briefly, burglary occurs in a private dwelling in the night, housebreaking in a private dwelling by day and in certain other buildings by day or night, and larceny is petty theft without any breaking of premises.

Very few policies are issued for private dwellings because the public naturally prefer the much wider cover afforded by a householders' comprehensive policy (see p. 576). Stock-in-trade, business fittings, plant and machinery are freely insured under business premises policies (usually cover against larceny is not included). In view of the many hold-ups, money insurance is popular to-day, and very wide cover is provided, including the fidelity risk of the messenger(s). Personal accident benefits for the messenger(s) can also be secured.

In the burglary section, too, "all risks" insurance is available to cover almost each and every risk for specified valuables, including pictures. There is a growing tendency to extend the range of "all risks" insurance so that transit insurances are arranged on this basis, and insurances of officers' effects, musical instruments, cameras and other types of property.

Some insurers issue baggage policies in the burglary department, while others do this through the marine department. They cover travellers' personal baggage on "all risks" lines, and personal accident and other risks may be included.

Miscellaneous. Many other types of insurance are transacted in the accident department.

Glass breakage insurance is sought by traders mainly because of the quick replacement service, in which insurers justly take pride. Stained glass windows in churches and other special types of glass are insurable.

Livestock policies are issued to cover loss through the death of animals—mainly cattle, horses, sheep, and pigs—by accident or disease. Foot and mouth consequential loss, swine fever, anthrax, and electrocution insurance are examples of the scope of this business.

Contingency insurance relates to various unusual happenings, such as loss of documents, missing beneficiaries, forged transfers, and breaches of restrictive covenants, which involve risks to the parties concerned against which they seek insurance protection.

Engineering Insurance. The major part of the premiums paid to engineering insurers is expended in inspection services, carried out by highly-skilled engineer-surveyors, and the furnishing of reports. Some types of plant must be periodically inspected to comply with the requirements of the Factories Acts, 1937–59, or Regulations made thereunder, and the reports furnished by engineering insurers are made in statutory form.

The main sections of the business are boilers and other pressure vessels, engines, electrical plant, lifts, hoists and cranes, refrigerators and other special risks such as machinery breakdown consequential loss, neon signs, X-ray apparatus, and the insurance of machinery in course of transit and erection.

Aviation Insurance. Aircraft hull insurance is transacted on somewhat similar lines to marine insurance, while aircraft and airport liability indemnities, personal accident insurance for passengers, products liability, and cargo insurance follow the general practice of accident insurance.

Accident insurances are so diversified that it is impossible to deal in detail with methods of rating, and for some classes of business, such as motor insurance, a number of factors have to be taken into account. Reinsurance is often required, and this is largely arranged by the treaty method.

NATIONAL INSURANCE.—This is in an entirely different category from insurance transacted by private enterprise. It is dealt with by the Ministry of Pensions and National Insurance and the contributions at flat rates[1] are made by the purchase of stamps at post offices. Such stamps have to be affixed to cards.

[1] When the National Insurance Act, 1959, comes into operation, there will be a system of graduated contributions to provide graduated retirement benefits.

THE OLD SCHEMES AND THE NEW SCHEME COMPARED

	New Scheme	Old Schemes
Weekly Rates—		
Sickness	50s.	18s. (10s. 6d. after 6 months).
Unemployment	50s.	24s.
Retirement	50s.	10s. (O.A.P.)
Increases for Dependants—		
Wife or other adult (wife only in the case of retirement pension)	30s.	None on sickness benefit. 16s. on unemployment benefit. 10s. O.A.P. for wife over 60.
First dependent child	15s.	None on sickness benefit.
Each additional dependent child	7s.	5s. on unemployment benefit for each of first two children, 4s. each other child. None on O.A.P.
Widows and Orphans—		
Widow's Allowance (13 weeks)	70s.	Widow's pension of 10s. with allowance of 5s. for first child, 3s. for each additional child.
First dependent child	20s.	
Each additional dependent child	12s.	
Widowed Mother's Allowance	70s.	
Each dependent child after the first	12s.	
Widow's Pension	50s.	
Guardian's Allowance	27s. 6d.	
Child's Special Allowance—		
First or only child	20s. (max.)	
Each other child	12s. (max.)	
Maternity—		
Maternity Allowance (for 18 weeks)	50s.	None.
Grants—		
Maternity Grant	£12 10s.	£2 (further £2 if wife was insured).
Home Confinement Grant	£5	
Death Grant (Adults)	£25	None.

The precursors of the scheme were the Benefit and Friendly Societies which made payments to their members in the event of sickness or unemployment. In July, 1912, National Insurance began and the majority of the Benefit and Friendly Societies became "Approved" Societies to administer certain standard benefits within the compass of the scheme. This "Lloyd George Scheme" related only to the lower income groups and to health insurance, with free medical attention from so-called "panel" doctors, and unemployment insurance. From 1926 the Widows', Orphans' and Old Age Pensions schemes grew up independently. Each scheme had its own administration, its own scales of contribution and benefit, and its own conditions. This piecemeal development naturally gave rise to all kinds of anomalies.

In June, , the Inter-departmental Committee on Social Insurance and Allied Services was set up, and in November, the chairman, Lord Beveridge, presented a personal report to Parliament. Eventually, the Government accepted the majority of the recommendations of the report and the scheme, with certain modifications, came into operation on the "appointed day," 5th July, The relevant Acts were the National Insurance Act, 1946, the National Insurance (Industrial Injuries) Act, and the National Health Service Act, 1946. The National Assistance Act, 1948, with the Family Allowances Act, 1945, completed the social security legislation. Various changes have been made subsequently by amending Acts.

The National Insurance Acts provided for a unified and comprehensive scheme of State Insurance which covers practically everyone in Great Britain. As noticed already, it is administered by the Ministry of Pensions and National Insurance and there are regional and local offices throughout the country. The population over school-leaving age is divided into three classes: Class 1, employed persons who work for an employer; Class 2, self-employed persons; and Class 3, non-employed persons. These three classes are all insurable compulsorily, but married women and certain other categories can be excepted from payment of contributions.

The weekly rates of contribution have been increased since the inception of the scheme. The current rates are as shown on p. 588.

The following benefits are provided: sickness benefit, unemployment benefit, maternity benefit, widows' benefits, guardian's

allowance, retirement pension, death grant, industrial injury benefits, and child's special allowance (introduced by the National Insurance Act, 1957). The table on p. 586 compares the rates of benefit paid under the current scheme with those paid under the schemes in operation before 5th July,

CONTRIBUTION RATES

Class 1.	Male employee	18 and over	9s. 11d.	employer	8s. 3d.
	,, ,,	under 18	5s. 5d.	,,	4s. 11d.
	Female employee	18 and over	8s.	,,	6s. 9d.
	,, ,,	under 18	4s. 8d.	,,	4s.
Class 2.	Men 18 and over	12s.		Women 18 and over	10s.
	under 18	6s. 9d.		under 18	5s. 11d.
Class 3.	Men 18 and over	9s. 7d.		Women 18 and over	7s. 7d.
	under 18	5s. 5d.		under 18	4s. 6d.

TEST PAPER

1. Upon what circumstances does the rate of premium for fire insurance depend?
2. Cite some of the main ways in which fire insurance benefits the community directly and indirectly.
3. Give an example of reinsurance on a fire risk.
4. Name a few of the safeguards which are commonly adopted with a view to securing a lower premium on a fire policy.
5. Explain briefly the purpose of consequential loss insurance.
6. What are the main purposes of life assurance?
7. What do you understand by a term assurance?
8. Mention two types of annuity.
9. What is a family income life policy? What are its advantages?
10. Mention six of the main types of accident insurance. What was the first class of accident insurance to be transacted?
11. Explain the term "fidelity guarantee insurance."
12. Account for the popularity of the comprehensive policies now available for the buildings and contents of private dwellings.
13. What steps have been taken by the State in recent times to improve social security?

ABBREVIATIONS USED IN TRANSPORT AND INSURANCE

A.R.	Against all risks
A.1.	First class
A.M.	*Assurance Mutuelle* (mutual assurance)
A.P.	Additional premium
A/R	All risks
B/L	Bill of lading
b.t.	Berth terms
c.f.	Cubic feet
C. and D.	Collection and delivery
c.f.i.	Cost, freight, and insurance
Cge.	Carriage
C.i.f.	Cost, insurance, and freight
Cld.	Cleared
C/P	Charter party
C.R.	Company's risk
C.T.L.	Constructive total loss
Cub.	Cubic
C.C.	Continuation clause
d.l.o.	Dispatch loading only
d.w.	Deadweight
D/C	Deviation clause
D.f.	Dead freight
e. & o.e.	Errors and omissions excepted
Frisco.	San Francisco
f.o.	For orders
f.d.	Free dispatch
F.O.B.	Free on board
F.O.W.	First open water
F.T.	Full terms
F.a.a.	Free of all average
F.a.s.	Free alongside ship
F.c.s.	Free of capture and seizure
F.f.a.	Free from alongside
F.g.a.	Foreign general average
Fm.	Fathom
F.p.a.	Free of particular average
Frt. fwd.	Freight forward
G.V.	*Grande vitesse* (quick goods train)
G.A.	General average
I.O.M.	Isle of Man
I.W.	Isle of Wight
I.H.P.	Indicated horse-power
Ince.	Insurance
In trans.	In transit
ldg.	Loading
L.I.P.	Life insurance policy
Min.	Minimum
M.D.	Millwall Docks
M.M.	Mercantile marine
N.R.	No risks
o.c.	Open charter
Oc. B/L	Ocean bill of lading
O.P.	Open policy
O.R.	Owner's risk
p.o.c.	Port of call
P.V.	*Petite vitesse* (goods train)
P.A.	Particular average
P.D.	Port dues
P.p.i.	Policy proof of interest
P. & O.	Peninsular & Oriental Steam Navigation Company
R.C.H.	Railway Clearing House
R.D.C.	Running-down clause
Shipt.	Shipment
S.L.	Salvage loss
S.N.	Shipping note
S.W.I.D.	South West India Dock
S. & F.A.	Shipping and forwarding agent
Thro' B/L	Through bill of lading
T.L.O.	Total loss only
Tonn.	Tonnage
T.R.	Tons registered
U/a	Underwriting account
U/w	Underwriter
W.P.	Without prejudice
Y.A.R.	York-Antwerp Rules
#	Numbers, or packages

SECTION VII—WAREHOUSING

CHAPTER LIII

FUNCTIONS OF WAREHOUSING

A WAREHOUSE is an establishment for the storage or accumulation of goods. Warehousing is one of the most important auxiliaries in the service of the trader, since by its means the necessity for delay in awaiting the arrival of goods from the producers is avoided. The chief functions fulfilled by this branch of commerce are—

(1) The removal of the hindrance of time which would otherwise be involved in obtaining possession of goods from the places of production.

(2) The regulation of the price of commodities by preventing the violent fluctuations which would result if such a store of goods was not accumulated.

(3) The provision of a market at which retail dealers and others may view the different commodities offered for sale.

For convenience of treatment, warehouses may be grouped into two classes—

(1) Public warehouses, chiefly located at the docks.

(2) Wholesale warehouses.

PUBLIC WAREHOUSES.—One of the most important developments which have been called into existence in the course of the last few hundred years is that of the warehouse which facilitates the turnover of goods. In the Middle Ages, when the mercantile marine, accompanied by a convoy, safely landed its treasures, they had immediately to be taken into consumption. What the merchant was unable to dispose of was subjected to the influence of wind and weathers, and to the danger of theft. Long before the goods were brought into consumption, the duties had to be paid. Whether the market was flooded or not, irrespective of demand and supply, the merchant had to dispose immediately of his goods. It was, therefore, a great boon when the first public warehouse was erected in London in 1660. This example was soon followed by other English seaports, and similar warehouses were also established in all

the ports of the Continent, as well as in the most important trading centres of the interior. At the present time, these warehouses, especially at the large seaports as at London, Liverpool, Havre, Hamburg, etc., are equipped with the most remarkable conveniences: Standing room is afforded near them for both ships and railway wagons, and accommodation is provided for the huge stocks of goods to be sold on the world market.

ADVANTAGES OF WAREHOUSING.—The main advantages of warehouses may be summarised as follows—

I. They serve to safeguard the stocks of the merchant who has either no warehouse of his own or very limited warehousing space. Hence, he is not restricted in his business operations through lack of room.

II. They make provision for the unloading of incoming and the loading of outgoing ships, as well as for the goods brought by rail. Consequently, the warehouses are equipped with expensive technical appliances: powerful steam cranes are used for lifting the heaviest loads; grain and other commodities are landed from the ships by hydraulic means and placed into the warehouses or into other vessels standing in the docks. In this way, the expenses of loading and unloading are kept at a minimum.

III. The merchant is afforded the convenience of having his goods stored in close proximity to his selling area, thus enabling him to serve his customers most economically and at the smallest expense. For example, a merchant in London trading with Australia may direct his goods to be warehoused at different seaports in the North of England, near to his customers, instead of receiving them all in London. A considerable saving in freight and in time can thus be effected.

IV. There is no necessity for the payment of duties immediately on the importation of goods. But for the provision of bonded warehouses, the importer would have to pay the import duty on their entry into the country. In addition to the cost price of the goods and the freight, the importer would also have to lay out an enormous amount of capital as duty. It can, therefore, be seen that it is a great convenience for the importer to be able to warehouse his goods without being called upon to pay the duty immediately. Such payment would be necessary only when the goods are sold and are thus brought into consumption. This very

important service is rendered by means of *bonded* warehouses, which are conducted by private enterprise or port authorities, though they are under the strict supervision of the State.

BONDED WAREHOUSES.—As the name suggests, these are warehouses with regard to the safe keeping of which the proprietors have entered into a Bond with the Customs authorities. The Bond is determined by various considerations, such as size, volume of trade, etc., and is drawn up by the Crown solicitor and the merchant or proprietor. Sureties are also required. Irregularities or fraud of any character are penalised by the cancellation of the Bond, and the consequent loss of the privileges which the Bond ensures.

GENERAL. In London, Bonded Warehouses are numerous, and distributed mainly around the wharves and docks. They may be roughly classified into the following groups—

(1) *Vaults.* For warehousing wines and spirits of all descriptions.

(2) *Tobacco Warehouses.* For warehousing and manufacturing tobacco (including cigars and cigarettes).

(3) *Sugar Refineries.* For the refining of molasses, raw cane, and beet sugar.

(4) *General Warehouses.* Warehouses for preserved fruits, and the various goods subject to duty other than those enumerated above.

As a general rule, warehouses are bonded for the warehousing of one class of goods only, although in many cases goods more or less similar are allowed to be warehoused in the same warehouse, but not on the same floors.

All Bonded Warehouses are subject to the supervision of the Customs officials, who remain, in almost every case, on the premises. They are also secured with Crown locks when closed.

Operations in Warehouse. When in the various warehouses, the goods are dealt with in such a way as to render them suitable for home consumption and export; in every case the permission of the Customs is necessary, and application must be made on special forms provided for the purpose. The nature of the operations varies with the character of goods. Briefly, the procedure is as under—

(1) *Wines and Spirits.* Racking, i.e. removing the contents of one cask into another or several others. Bottling, i.e. removing contents of casks into bottles for home consumption.

(2) *Tea.* Blending and re-packing various teas, e.g. teas from China, India, or Ceylon are blended and re-packed into small packets for home use.

(3) *Tobacco.* Blending and re-packing.

TRANSFER OF OWNERSHIP OF WAREHOUSED GOODS.—Warehouses also render other valuable services to trade. Among these may be mentioned the facility for transferring the ownership of warehoused goods. Just as the ownership of goods shipped by a certain vessel can be transferred by the endorsement of the Bill of Lading, so the goods stored in the dock warehouses can be so transferred. This is effected by means of a " Warrant." In this document, the warehouse authorities certify that they have received the goods stated thereon, and undertake to deliver the same to the bearer of the " Warrant," who is regarded as the legitimate owner. It is usually made out to " order " and is negotiable by endorsement.

The merchant who has warehoused his goods, or the person authorised by him, may reclaim them at any time. When reclaiming the whole of the warehoused goods, he must produce the warrant to the authorities, in return for which he receives the Delivery Order, which empowers the warehouseman to deliver the goods. If only a portion of the goods is required, the corresponding quantity is written off the warrant, which is then returned to the owner of the warehoused goods.

The holder of the warrant can also sell the goods by delivery of the warrant with his endorsement thereon, and the buyer can dispose of them in the same way. Thus, a consignment of goods represented by " warrant " may change hands repeatedly on the world market without being once moved from the warehouse.

It is therefore possible for the merchant to carry about in his portfolio the title to whole ship-loads of goods and to dispose of them by a mere stroke of the pen. Naturally the sale of goods against warrant presupposes an unlimited confidence in the warehouse authorities.

All goods which are warehoused must be insured against loss by fire, protected against theft, and preserved from deterioration. Goods which are unsuited for warehousing are not accepted, except under special conditions. The warehouse authorities are able to protect against all risks, except one, viz. a change in value consequent upon the fall in market prices. On the other hand,

the warehouse offers excellent advantages for public sale. At many warehouses, especially in London and Amsterdam, public auctions have been established at which Colonial goods are periodically sold by authorised brokers. At these auctions, all the most important wholesale dealers attend, or are represented by their commission agents.

Warehouses are important not only to the importer, but also to the home manufacturer and exporter, since they offer a number of advantages to them in the conduct of their trade. Instead of accumulating his stocks of finished goods in his own warehouse, the manufacturer may prefer to place them at the disposal of the market by storing them in the warehouses of the chief trading centres. In this way, he has a better chance of selling them when the favourable moment occurs.

To the various services rendered by the warehouse to the importer and exporter, as well as to the manufacturer, should be added the facility offered for the hypothecation of the goods; that is to say, while still retaining the ownership of the goods, the merchant might pledge the warrant, in order to raise a loan. It is very important that merchants and manufacturers should thus be able to hypothecate their stocks for, by so doing, the former, in times of crisis, can meet their obligations out of the loan thus raised, whilst the latter can continue their productive operations instead of having to discharge their men.

WAREHOUSES UNDER THE PORT OF LONDON AUTHORITY.—It is estimated that about 60 per cent of the shipping entering the Port of London discharges in the docks; whilst the rest discharges at wharves or at moorings in the river. From vessels which go into the docks, a large portion of the cargo is taken away by lighters, which have, by statute, the right of free access to the waters of the docks. Another portion is discharged on to the dock quays for conveyance to its destination by land; while yet another part, not intended for immediate consumption, goes directly into the warehouses of the Port of London Authority. This warehousing business is of great importance, comprising, as it does, every class of goods entering the port. The principal are grain, timber, wool, frozen and chilled meat, sugar, tea, wines and spirits, and tobacco. The whole of the tobacco warehoused in London is stored with the Port Authority.

As a body, the Port of London Authority are not growers, producers, or importers of produce, but simply custodians who perform such operations as the owner of the goods may direct. They house the produce discharged from vessels, and report upon its weight, quality, and condition to the merchants interested.

The Authority is the greatest warehousekeeper in the world; its operations range from the simple service of merely allowing goods the right of passage through its sheds to the most complicated examination and manipulation of products of all kinds. All the services required by merchants are performed by the Authority's staff who require years of training and experience to qualify them for their work. The services rendered by the Authority include, besides the safe custody of the goods, all the operations required by the merchant in the course of marketing, sale, and delivery of his goods. These operations are often various and responsible The catalogues issued by the brokers, describing the goods offered by them for sale, are prepared from descriptions of the quality and condition, weight, and other essential particulars required to be known by the buyer, furnished by the Authority's staff; whilst the grading and letting of the goods in a way suitable for the market is also done on their advice. Samples to show indications of the bulk have to be drawn and in such goods as rubber and fibres the judgment of the expert is necessary. The examination for damage to goods in order to ascertain liability as between the parties interested is another duty demanding not only skill but the strictest impartiality, and constantly the Authority is placed in the position of an arbitrator between buyer and seller. By the issue of the dock warrant to merchants, the Authority affords facilities for financing commercial operations, and by arrangement with fire insurance offices the warehouses are protected financially in case of fire. The weighing and measuring of the goods, the separation of damaged from sound goods, and the making merchantable of salvage goods, are amongst the operations conducted as part of the everyday routine work in the warehouses. The services of the Authority as warehouse-keepers are supplemented by that of carriers in that they undertake the collection and delivery of goods to and from the domicile of merchants and manufacturers, employing for this purpose railway, lighterage or cartage facilities provided by them at their docks and depots.

TEST PAPER

1. What are the functions of a warehouse ?
2. Mention two classes of warehouses.
3. Summarise the main advantages of *public warehouses.*
4. What are Bonded Warehouses and for what purpose are they used ?
5. Show to what extent specialisation has arisen in the sphere of warehousing.
6. Why are Bonded Warehouses under supervision of the Customs authorities ?
7. How may the ownership of warehoused goods be transferred ?
8. Compare a public warehouse with a market.
9. What is meant by the hypothecation of warehoused goods ?

CHAPTER LIV

Wholesale Warehousing

THE WHOLESALE WAREHOUSE.—The wholesale warehouse is chiefly concerned with the purchase and sale of commodities; and for the conduct of this work in the most profitable manner, special ability is required which consists chiefly in the power to utilise the existing market phenomena with care and dexterity, the possession of business tact, a grasp of the prevailing conditions with reference to the supply of goods, insight into the character of buyers and sellers, as well as high moral qualities combined with a store of physical and mental energy on the part of the organiser.

GENERAL ORGANISATION OF WHOLESALE WAREHOUSE.—The organisation of the wholesale warehouse can only be dealt with in general terms. From that point of view, the business can be regarded as being organised into three main departments—

(1) The Buying Department.

(2) The Selling Department.

(3) The General Administrative Department.

THE BUYING DEPARTMENT.—The nature of the business will probably be such that it deals in many quite different varieties of goods and, therefore, there will be subdivisions according to the different classes of goods dealt in, and each of these will be called a department. Each department is usually controlled by a manager, who is known as the *Buyer*. The departmental manager is primarily responsible for the buying of his department, so that the business is grouped as a whole; the purchase of goods of a particular description is thus effected by a responsible person, and in this manner a stock is provided from which customers can select the goods they want to buy.

QUALITIES OF A GOOD BUYER.—The chief duties of the buyer are to get into touch with the best sources of supply, to find out the conditions and limitations in connection with the goods that can be supplied, to place orders, and to keep in touch with new ideas. It is clear that the good buyer must be decidedly unimpressionable to others; he must be a man with his own

opinions, and capable of holding them sufficiently to prevent him from being talked over by others who may be interested in so doing.

AUTHORITY OF THE BUYER.—The departmental buyer may be granted authority to buy from the source he thinks best ; or the General Manager, who is responsible for the business as a whole, may sanction his suggestions before they can be acted upon. As to which of these two plans is the better will depend upon the personality of the departmental manager and the General Manager. Given two persons in responsible positions—one subordinate to the other—the problem is to find the best arrangement to promote efficiency in the best sense of the term. Unless the men work together well and both are satisfied with the terms under which they work, efficiency cannot be obtained.

If the general manager knows a great deal more about the business than the departmental manager, it seems reasonable that the general manager should really control the departmental manager's actions. In that case, the departmental manager may be little more than an assistant manager, so long as the general manager possesses the knowledge and experience to enable him to fill the position. If he is not possessed of the necessary knowledge, time, and energy, it is very much better that he should not attempt the work. But if the management of the department is in the hands of the buyer, then, on the whole, the less he is interfered with from above, the better the results will be. This means that he is given a free hand within certain specified limits, and is judged according to the results he is able to produce.

As a rule, the best results will be achieved by giving the departmental manager or buyer a free hand to purchase where he likes, but that may be subject to modification. For example, whenever he opens a new account, he may be required to report the fact to the general manager, with a short statement of his reasons for opening such an account. The mere fact that he has to do this is a reminder that, other things being equal, one does not require to open new accounts merely for the sake of doing so. A business house is likely to get more consideration from its sources of supply if the orders it gives are sufficiently large. It is therefore important to remember there is a limit to the splitting up of orders given.

CHIEF FACTORS IN BUYING.—The main factors which should influence the buyer in placing his orders are—

(1) The nature, quality, and description of the goods.

(2) Whether they are the goods he wants.

(3) Whether the prices are suitable.

(4) Whether the time of delivery is suitable.

(5) Whether the delivery will be in accordance with what was ordered.

It is largely owing to the great inconvenience caused by not getting what was expected when delivery comes, that, as a rule, it is better to buy from houses that one does know rather than from strangers.

Good business houses are always striving to build up a good reputation; and one of the most important items in that reputation will be not merely that the goods come to hand at the time they were promised, but that when they come to hand they are of a saleable description in every sense of the term.

Supposing an order has been given for chinaware and, when it is delivered, about 30 per cent of the goods are broken. It is not merely a matter of seeing that the manufacturers give credit for what is broken, but there is the trouble of sorting out the defective goods and the use of additional warehouse space involved. Under proper conditions, there would have been no need to look through the goods, but they could have been sent direct to the customers if ordered. Thus, there is a great saving if the goods are received in a merchantable condition.

POLICY OF THE BUYER.—The buyer may be said to have two business policies to choose from in deciding what commodities he will deal in. He may—

(1) Get into touch with the customers and supply them with what they want; or

(2) Find the most saleable articles and then try to push them on to the customers.

When the customers of the wholesale warehouse are themselves expert buyers, the probability is that they know what they want before they make out their orders, and will not depart from their intention. Occasionally, however, they may be induced to order something they have not seen. The prudent policy of the wholesale buyer is to find out what the customers want, and then consider the

buying from that point of view instead of always launching out on new lines. On the other hand, if the customers are the general public, as in the case of the retail trade, the question is not so much as to whether they want the goods or not, as to whether they can be persuaded that they want them. Here the chances of selling will be increased if the most saleable kinds of articles are considered beforehand and then stocked heavily without waiting for orders.

Speaking broadly and subject to a considerable margin for exceptions, it may be said that in the wholesale trade less initiative is required on the part of the buyer than in the case of the retail business. This is, of course, a broad generalisation and subject to considerable modification in practice.

THE SELLING DEPARTMENT.—The next division of activity in the wholesale warehouse is what is known as the Selling Department. The object of this department is to find purchasers for the goods that are on sale in the warehouse, and to get orders for goods which are capable of being executed. The possibilities of organisation in connection with the Selling Department are as yet but little understood in England. This is shown in the fact that very commonly there is no recognised division between the buying and selling departments. Very often the skilled buyer is also made responsible for the selling of the goods. In one sense, this is convenient, since there is no divided responsibility; and if the buyer has to find purchasers for the goods he has bought, he cannot shift the responsibility of the failure for so doing on to someone else. But if it is recognised that the selling of goods is not the same thing as buying them, and that there is scope for the exercise of different qualities in successful salesmanship as compared with successful buying, the probability is that these qualities are not likely to be found to their fullest extent in the same individual. Hence, where the business is sufficiently large, buying and selling should be kept as distinct departments, so long as they can be so co-ordinated as to work together harmoniously.

QUALITIES OF A GOOD SALESMAN.—If a salesman is to be a success, he must be an optimist. He must be able to see the good points of the goods he has to sell and, further, he must exercise some sort of influence on customers, so that, if possible, he can infuse his optimism into them and get them to buy.

In these days of competition, a business house that makes no attempt to get orders out of customers is likely to be left behind. If the trader is to effect an increasing turnover, he must use every effort to find new methods of reaching his customers.

Of course, the art of salesmanship consists of a great deal more than simply being on the spot ready to attend to customers when they come. But even here there is some scope for the peculiar qualities of the salesman. It is clearly important to get the customer in the right vein to appreciate what the salesman has to say. The customer is human and has to be instructed. This may require great tact, because he may have to be instructed (without giving offence) as to what he really wants or ought to want—a point about which customers are very sensitive. They think they know their requirements, when perhaps they do not.

It is the art of salesmanship which should be used to induce the right frame of mind on the part of the customer. This applies particularly in the retail trade, where the salesman comes into direct contact with the general public and also, in a lesser degree, to the wholesale salesman whose customers are skilled professional buyers. It may not always mean that the customers are persuaded to buy goods that they do not want, but they may be led to place orders that they intended to place elsewhere.

WHOLESALE METHODS OF DISTRIBUTION.—It is one thing to provide a salesman competent to handle customers, but the wholesale house which desires to increase its business substantially must look a little farther afield for new trade—either trade with new customers, or trade extending over a wider area of goods, or both. Examples of both these methods can be seen in operation at the present day. Progressive business houses increase their premises to cope with increased business, and this, in turn, brings an increase in the number of their regular customers engaged in either the wholesale or retail trade. Along with this activity, business houses are constantly adding new departments or embarking on new kinds of trade, which they carry on side by side with their existing business. In this way, they are able to cater for other wants of existing customers, which hitherto had to be fulfilled by other persons.

The expansion in the direction of new activities and new departments seems to meet with greater promise of success in

the case of wholesale houses with a good *clientèle*. But it is no good starting trade in new lines of goods of which one has but little knowledge, for, to be dealt with effectively, each kind of goods requires its own kind of knowledge. To some considerable extent, the want of knowledge of details may be supplied by engaging really competent buyers of the new departments. The buyer should have all this detailed and specialised knowledge even more than the general manager, who should ensure that this is the case.

When it is a question of trying to acquire new customers, there are, broadly speaking, four ways of proceeding—

(1) **To Rely upon Reputation and the Recommendation of Existing Customers.** This is a slow process at the best. In the retail, it is a usual practice, but is not of much use in the wholesale trade. The reason for this is that the customers of a wholesale trader do not see very much of each other. Their opportunities of communicating with each other are not great, in addition to the fact that they are, in the nature of things, competitors.

(2) **To Employ Travelling Salesmen.** It is the duty of travelling salesmen to call upon business houses, to show samples of goods to prospective customers, and to do their best to get trial orders. One trial order having been obtained, it may be usual for the business to rely upon the value of the goods and upon their general reputation to get repeat orders from it. This does not mean that when once the trial order has been given, the traveller has not to interview the customer again ; on the contrary, he must constantly nurse the customer.

In the wholesale trade, there is great scope for the development of trade by means of travelling salesmen. This is particularly the case where the probable customers are residing at some distance from the firm's headquarters (e.g. the provincial trade in regard to a London house).

(3) **To Appoint Agents.** The appointment of agents by the wholesale firm serves exactly the same purpose as that of the travelling salesmen, except that the agent, as a rule, is resident in a centre where he is already fairly well known, and therefore has a better footing than could be obtained by itinerant travellers.

(4) **To Use the Medium of Advertising.** In regard to the wholesale trade, advertising is most marked in the case of branded goods.

It is of little use for the wholesale house to advertise in the hope that retailers will notice the advertisements, and will instruct their buyers to call and see whether the house is worth patronising.

If a wholesale house sells goods bearing a specific name, it may with advantage advertise, in order to appeal to the general public. If the advertisement is successful, it will create a demand by the general public which will cause retailers to place orders with the wholesale house. In so far as the articles are of such a description that the orders must come to the advertisers, it may be a good thing; but if the orders may go to substitutes, the advertisement may prove wasteful.

SELLING—THE LINK BETWEEN BUYING AND FINANCE.—The salesmen, whose business it is to supply the requirements of customers, have opportunities of finding out what the customers really want, which the Buying Department, as such, does not possess. Customers will state their wants, and it is an essential factor of the sound organisation of a wholesale house that any want which cannot be filled out of stock should be communicated to the Buying Department with a view to seeing whether it ought to be stocked. This is important, because the customers of the wholesale house are themselves professional buyers, who presumably know their business.

In the same way, the Selling Department must keep in touch with the Finance Department, or chaos will soon result. Just as no business house can afford to buy without considering how much capital may be locked up in stock, so no business house can afford to sell on credit without considering how much capital may be locked up in book debts. This is a question of finance and not of selling.

Salesmen, being temperamentally optimistic, are not to be trusted in deciding as to whom credit shall be given and upon what terms. The Finance Department should look after this work without causing any friction. The linking up of one department with another may easily cause friction if it is not done with considerable ability and with the exercise of reason.

GENERAL ADMINISTRATIVE DEPARTMENT.—It has been seen that in connection with both buying and selling, a considerable amount of expert knowledge is required with regard to the particular kinds

of commodities that are being dealt in; whereas what constitutes ability in the direction of finance or administration is really very much the same under all conditions, whatever the precise class of goods may be. A capable administrator of one kind of business should, with comparatively little expenditure of time, make himself capable of managing another business.

Financial Administration. The first point to be considered is that of capital, since any kind of business house, if it is to be financed on sound lines, must have a certain amount of capital adventured in the business. What is meant by capital is a definite fund represented, in the first instance, by money or by some form of property capable of being used with advantage in connection with the business. It must, therefore, consist, either directly or indirectly, of money permanently adventured in that undertaking, and must not be capable of being withdrawn at the whim of anybody desirous of using it for other purposes. When a wholesale house is organised on the lines of a limited liability company, it is natural that it should have a capital of that description. In fact, the company law of this country fits in with the requirements of the position in that it expressly provides that capital subscribed by the members of the company shall not, except in very special circumstances, be returned to them during the time the company is in operation as a going concern.

Whatever the nature of the business, any serious drain upon its capital, or repayment of capital to members, must leave the undertaking in a more difficult position to carry on the undertaking than before. It must, therefore, be assumed that there is not merely a fund for the purpose of financing the business, enabling it, when necessary, to pay its debts without being forced to a realisation of its assets, but also a fund for any unforeseen contingencies. Sometimes in connection with a wholesale business, there may be one or two seasons of the year when standing expenses exceed the normal profits. It is necessary to have capital to tide over a period of that kind, and still more to tide over quiet times which do not recur with regularity.

Capital is also required for the purpose of providing equipment, after the payment for which there should be left a sufficient margin as *working capital* to finance the concern. Working capital is required, because in the normal course of events, money is spent

before it comes back with a profit in an augmented form. Money must be spent before one receives, although there are some exceptions to this rule. Some businesses sell only for cash, and therefore they receive payment for the goods they sell before they themselves have paid for them. Such businesses, however, would not be included under the heading of wholesale concerns.

The probability is that the wholesale house will give a longer period of credit to its customers than it receives from its supplying house. Here, again, there are exceptions dependent upon particular trades and different classes of customers. If the customers of the wholesale warehouse are customers carrying on a cash trade, the probability is that they will be anxious to get close prices on what are known as *prompt terms*, and in those circumstances it is very likely that the wholesaler will receive payment before he himself is obliged to pay for the goods he has bought.

Debentures. It is an open question whether there is absolute safety in connection with investment in a wholesale warehouse. It is, therefore, customary to issue capital in the form of debentures. In the strict sense of the term, these are not capital at all, but simply money lent at a fixed rate of interest and repayable on fixed dates. The majority of persons who invest their money in debentures consider that the debentures are secured by a mortgage on the assets of the business, although this is not always the case. When they are secured and the assets are of sufficient value, the security is good; and if there is a default in the payment of interest, the debenture holders can put the law into motion and compel the assets to be sold. Their claim ranks before that of creditors, who are not similarly secured.

TEST PAPER

1. Into what three main departments can the organisation of the wholesale warehouse be divided?
2. What are the qualities of a *good buyer*?
3. What authority should be conferred upon the buyer of a wholesale warehouse?
4. Enumerate the main factors which should influence the wholesale buyer in placing his orders.
5. With what two business policies is the wholesale buyer confronted when deciding what commodities he will deal in?
6. Under what circumstances should the selling department of a wholesale warehouse be separated from the buying departments?
7. Compare the qualities of a good salesman with those of a skilled buyer.
8. What four methods are adopted by the wholesale warehouse in order to acquire new customers?

9. Show how selling acts as the link between the buying and financial departments.

10. Mention some of the points to be considered in financing a wholesale warehouse.

11. Compare the methods of the wholesale trader and of the retail trader in the purchasing and selling of commodities.

12. State the functions of a wholesale warehouse and indicate a suitable scheme of organisation that will adequately control these functions.

13. Explain the important differences in the organisation of a wholesale warehouse as compared with that of an ordinary retail shop.

14. If all wholesale business were abolished and goods were sent directly to the retailer from the producer, in what ways would the shopping public probably be affected?

CHAPTER LV

The Meaning and Calculation of Turnover

The endeavour to obtain the maximum return to his efforts leads the merchant into the avenue of economy (i.e. to effect his part in the exchange of goods with the least possible expenditure). His private interest is the realisation of a large profit, which consists in the difference between his buying and selling prices, so that the principle of cheap buying and dear selling evolves quite naturally. The wholesale trader endeavours to purchase his goods as cheaply as possible from the manufacturer or producer, so that, in practice, the art of trade consists in the application of all those means and methods to attain that end. For this purpose, the merchant must take a clear view of the whole market, such as the supply of goods in the hands of the manufacturers or producers, the visible and invisible stocks, the conditions of production with their attendant drawbacks, and a most careful study of the fluctuations of trade as far as his specialised commodity is concerned. In doing this, he certainly acts in conformity with economic principles.

Limitations to Cheap Buying.—There are, of course, limits to cheap buying. If the manufacturer has the choice of several buyers in the disposal of his goods, he will cut off his business relations from those who seek to take advantage of him. Again, every merchant who intends to make a permanent living out of trade, and who desires to secure reliable sources of supply, must aim at giving fair treatment to those who supply him. The fact must not be overlooked that it is possible for the manufacturers to combine for the purpose of selling should the merchant refrain from offering a fair market price. The single business, therefore, digs its own grave if it is impelled solely by selfish motives when effecting its purchases. Buying cheaply has, therefore, its limits, which are determined by competition and the considerations of a permanent and secure business connection.

From a business point of view, it is unwise for a trader—whether wholesale or retail—to change his dealers whenever a lower quotation is offered to him. Naturally, he will compare the various

offers made to him, with regard to their quality and price, with those at present supplied to him; but, at the same time, he must also examine whether the new quotation is nothing more than a bait, and whether the new firm would be as capable of serving him as the present, and whether his special wishes and requests respecting the time of delivery and quality could be executed. From a consideration of these important factors in buying and selling, it must be concluded that the cheapest quotation is not always the best.

LIMITATIONS TO DEAR SELLING.—The same applies to the principle of selling in the dearest market. However natural it may appear that a merchant, in his endeavour to increase his profit, must strive to fix his selling price as high as possible, the wise merchant must, above all, be moderate in the settlement of his prices. Apart from the fact that he must ever take into consideration the question of competition in fixing his selling prices, the merchant can acquire a permanent *clientèle* only by meeting his customers in a reasonable manner, especially since business success does not, as a rule, depend on a single transaction, but on a permanent connection and a regular *clientèle*, which the merchant can secure only by working at a small profit. However paradoxical it may seem, the correct principle of business practice is to sell as cheaply as possible, assuming naturally that the limits of the selling price have been fixed by a careful analysis of the cost. The analysis of the cost must lead the merchant to observe that the difference between the buying and selling prices, or the *profit* on a single transaction, forms but one of the three factors on which together the success of an undertaking depends. The other two factors are the *magnitude* and the *rapidity* of the turnover.

An example will explain the mutual dependence of these three factors—

Let us suppose three competing merchants—A, B, and C—are dealing in wheat.

A buys 100 qrs. wheat at 15s. qr. and sells them at 16s.; he turns over this quantity every month: therefore his yearly profit amounts to 1;200s.

B has a turnover each month of 400 qrs., which he purchases at 15s. 2d. and sells at 15s. 8d., thus gaining 6d. on each quarter, and his yearly profit amounts to 2,400s.

C buys 400 qrs. at 15s. 4d. and sells them at 15s. 6d., but can effect a turnover of over 400 qrs. per week. Although his profit on each quarter of wheat is only 2d., he makes a yearly profit of 3,466s. 8d.

The first merchant (A) acts according to the principle of buying in the cheapest and selling in the dearest market; whilst B acts on the principle that, in spite of a lower selling price, a bigger profit can be obtained with a large turnover than with a big profit and a small turnover. C recognises the basic principle—the effect of a large turnover—but to this he adds a new principle in that he turns over the same quantity not monthly, but weekly, and thus obtains the highest total profit, although he buys in the dearest and sells in the cheapest market. His guiding business principle is to effect a speedy turnover.

From this example, further conclusions may be drawn. A pays to the producer 15s., B 15s. 2d., and C 15s. 4d. per quarter.

In effecting his purchase, C will defeat his competitors A and B, or at least will render less favourable their conditions of purchase. Again, since C also comes in touch with the consumers with the lowest selling price of 15s. 6d., whereas B demands 15s. 8d. and A 16s. per quarter, he will immediately capture the best customers and thus relegate the other sellers into the background. To this is added the greater efficiency, regularity, and better organisation which C possesses over A and B, which will benefit the parties which are brought together by him, viz. the producer and the customer. The more efficient the business organisation, the more effectively does trade play its part in the national economy. Moreover, from the example above given, it will be seen that the individual's desire to make profit leads automatically to higher economic principles; and that the well-known commercial maxim of buying in the cheapest and selling in the dearest market is by no means the determining one, but must subordinate itself to other principles, and especially to that of effecting a speedy turnover.

A simple arithmetical example has shown that the effecting of a large turnover is of the greatest importance to trade.

Attention will now be drawn to some general points which must be kept in mind in the endeavour to achieve this end.

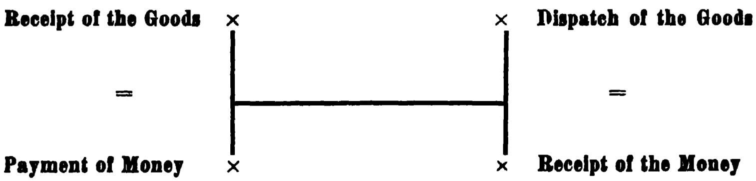
INFLUENCE OF A LARGE TURNOVER ON TRADE.—The aim of

to the command over capital. The latter, however, are the exceptions rather than the rule, so that, apart from these, superiority is to be sought for in the normal factors, such as in a more complete organisation of business, whether in regard to purchasing, warehousing, selling, working expenses, quality, cheaper prices, goodwill, in the better adaptation to the requirements of the customers, or in greater activity and initiative.

INFLUENCE OF THE PERIOD OF TURNOVER.—In addition to the two factors—the difference between the purchase and selling prices (i.e. profit) and the magnitude of the turnover—there comes a third: the period of the turnover or the necessity of effecting the turnover as speedily as possible.

In order to explain the relationship existing between the time and the magnitude of the turnover in reference to the practice of commerce, it is necessary to examine the basis of the circulation of business capital.

If the goods are bought with cash on the spot and again sold for cash, the whole circulation of the turnover is limited by two points of time. The starting-point for the period of the turnover is the day on which the goods were received, and with this coincides the day of payment. The termination of the period of turnover, or the circulation of the goods, is the selling day when the goods are dispatched, on which, according to the above illustration, payment is received for the goods.



If, however, the purchase and the sale are not effected in one and the same place, but at a distance and on credit, there result four points of time, which as a rule, come in the following order—

Receipt of Goods — Payment of Money — Sale of Goods — Receipt of Money.

Various modifications, however, are possible. The time for the payment of money may be effected after the sale of the goods; indeed, even after the time of receiving the money.

STATISTICS.—These are important to the manager of a wholesale trading concern because they enable a comparison to be drawn between past and present results, with the two-fold object of increasing output or reducing expenditure so as to increase profits. All items of expenditure can be classified and readily compared with the relative amounts of the previous period, thus bringing under review excessive expenditure which would not otherwise be so apparent. The output and profits can, however also be taken into consideration.

TEST PAPER

1. Mention some limitations to cheap buying.

2. "The profit on a single transaction forms but one of the three factors on which together the success of an undertaking depends." Examine carefully this statement and name the other two factors.

3. Criticise the well-known commercial maxim of "Buying in the cheapest and selling in the dearest market."

4. Enumerate some of the factors which enable the wholesale merchant to effect a large turnover.

5. Explain how the period of the turnover is calculated when goods are bought for cash and sold for cash.

6. (*a*) What connection exists between the rapidity of turnover and a trader's profits ?

(*b*) A retailer had £2,000 invested in his business. His turnover for the year was £5,000, and his gross profit 10 per cent on the turnover. If his expenses amounted to £250, what was the rate of his net profit on turnover and on capital ?

7. A trader is asked to sell at 2s. 6d. an article, A, which is sold to him for 2s. Another manufacturer offers him a slightly inferior article, B, of the same kind for 1s. 8d. to sell also at 2s. 6d. Find his gross profit and his percentage of gross profit on turnover in the three following cases—

(*a*) He buys 12 doz. of A and 8 doz. of B, and sells them all in two months.
(*b*) He buys 18 doz. of A and sells all in two months.
(*c*) He buys 12 doz. of B and sells all in two months.

Which of these three courses is the most desirable to pursue, and why?

8. A merchant's accounts reveal the following position for two successive years—

1st Year	£	*2nd Year*	£
Sales	20,000	Sales	25,500
Sales Returns	1,000	Sales Returns	1,500
Gross Profit	8,000	Gross Profit	9,500
Expenses	5,000	Expenses	6,000

Find (*a*) the percentage of gross profit to turnover in each of the two years; (*b*) the percentage of net profit to turnover in each of the two years. What useful information is provided by these calculations?

CHAPTER LVI

PROFITS IN RELATION TO TURNOVER AND WORKING EXPENSES

A TRADER who turns over his stock only once during the whole year must fix his profit fifteen times as high as that of his competitor who turns over his goods in twenty-four days, if he desires to earn the same total profit. Moreover, his competitor has the advantage over him in several ways. The long warehousing of the goods entails labour, interest on capital, and warehousing expenses. It is also possible that the goods may be depreciated in consequence of a long period of warehousing.

THE DIRECT EXPENSES OF WAREHOUSING.—As may be seen from the price list of any firm of warehousers, the expense of warehousing grows in proportion to the length of the warehousing period. The same, of course, applies if the trader stores the goods in his own warehouse. Hence, in the calculation of the warehousing expenses, account must be taken of the rent, depreciation, and maintenance of the warehouse buildings, and these expenses have to be spread over the various goods in proportion to the time and space occupied by them. Therefore, the quicker the goods pass through the warehouse, the smaller is their share in the warehousing expenses. Many concerns, and especially those engaged in the intermediary trade, try to avoid altogether the expense of warehousing the goods. For instance, commission agents engaged in the import and export trades often sell goods afloat even before the arrival of the vessel. Again, they may only undertake to consign goods abroad when they have found a customer for them. In fact, it is the rule in export trade for the trader to have no warehouse at all. In certain branches of the wholesale trade, a definite period is allowed for the acceptance of the goods, so that the exporter has an opportunity of selling these goods within that period without the necessity of warehousing them. Hence, he saves not only the warehousing expenses, but also the carriage inwards and outwards.

On the other hand, there are many undertakings which are compelled to maintain large warehouses; and especially in those wholesale and retail trades which desire to offer their customers,

not only a large selection of goods, but also to keep large quantities for sale. This is also the case with goods which cannot be turned over within a short period, such as fancy goods, watches, etc. Very often, also, the period of warehousing is prolonged when it has an influence on the appreciation of the quality, as in the case of wines, spirits, pictures, and stamps. Here the warehousing expenses are amply compensated through the increase in value of the goods. Indeed, in such cases the stocks may be considered as a lucrative investment of capital.

WAREHOUSING, LABOUR, AND OTHER EXPENSES.—Almost all goods require, during their period of warehousing, a careful treatment against internal or external decay. Some have to be protected against dampness; others against dryness, heat, cold, light, wind, and weather; some are subject to depreciation, others to leakage and evaporation. Some, such as woollens, corn, and flour, are endangered by insects; whilst others are injured by rust and loss of colour. All goods warehoused must, without exception, be insured against fire and theft.

Depreciation. Only in the case of a few goods is their quality or value increased through warehousing. As a rule, depreciation sets in, and this is all the greater the longer the period of warehousing; most noticeable is this in the case of fashionable goods. Fortunately, almost every fashion finds its way from the capital into the small towns, then into the villages and into the remotest parts of the world, so that the warehouser is able to send into the provinces stocks which happen to be unfashionable in the capital. The necessity here arises, however, of clearing the stock at the right price. To-day, not only are clothes slaves to fashion and its changes, but nearly all commodities, such as watches, fancy goods, furniture, china, pictures, books, and a thousand other articles. Therefore, the risk of the depreciation of goods in the warehouse is spread over a large number of commodities, and it is worth while to point out the means at the command of a mercantile concern to provide for this depreciation.

In the first place, an amount can be added to the cost price for the depreciation of the unsaleable stock. For this reason, the so-called articles of novelty are the dearest. Another means is the clearance of the warehouse at the end of the season by the holding of special sales.

One of the greatest mistakes in business is the failure on the part of the proprietor or manager to clear the old stock at the right time and the unwillingness to reduce the prices in the false hope of finally obtaining the old prices. If he has calculated correctly and has included in his selling price an amount for the depreciation of the unsaleable stock, then the reduction of price and the allowance at sales is only an apparent loss. Although the merchant may correctly estimate the warehousing expenses and the depreciation, he will risk much more if he keeps old stocks for long periods of time. One of the requirements of a satisfactory business system, therefore, is the periodical checking of the stock and the clearance of antiquated goods. This applies not only to retailers, but is also applicable to the wholesale trade.

The quicker the turnover, the smaller is the capital required for an equally large turnover. That concern which turns over slowly its capital will require more than its competitor which effects a more speedy turnover.

For example, suppose the yearly turnover of A and B is £100,000 each: A turns over the goods in thirty days, B in 180 days; then A has an average stock of £8,333 and B one of £50,000.

From this example, it is clear that the art of conducting trade on a small capital is based chiefly on a speedy turnover. Moreover, the longer the period of warehousing, the greater the *loss of interest.*

In the above example, on the single turnover A entails a loss of ½ per cent interest, whilst B loses 3 per cent interest (i.e. A has only to account for the sixth part of that which B has to add).

In marshalling these points together, it must be concluded that the art of trade is to be found especially in a speedy turnover, not merely because the profit earned on each single turnover multiplies, but because the trading expenses diminish in the same proportion as the number of increments of profit increase. With a sixfold increase in the speed of the turnover, all direct and indirect warehousing expenses become six times smaller, whilst the return on capital outlay in the purchase of stocks becomes six times greater.

In practice, this calculation, under the influence of competition, assumes another form. The sixfold diminution of the expenses and the sixfold increase in the profit will allow the merchant in

question to act according to the principle of "Small profits, quick returns." To triumph over his competitor, he will enter the market with cheaper prices, thus affording another means of effecting a speedy turnover. Hence, it is again seen that the more economically the business is performed through a speedy turnover, the greater will be the decrease in the expenses of distributing the goods, and the more beneficial a part does trade play in the service of the producer and of the consumer.

TEST PAPER

1. Show clearly how the increase in the warehousing period tends to raise the price of goods.
2. In what way is the period of turnover related to working expenses ?
3. "The quicker goods pass through the wholesale warehouse, the smaller is their share in the warehousing expenses." Elucidate this statement.
4. Name some commodities in which the prolongation of the period of warehousing is an advantage to the owner.
5. To what risks are warehoused goods subjected ?
6. "The art of trade is to be found chiefly in a speedy turnover." Explain this statement
7. Given the undermentioned information, find—
   (*a*) The percentage added to cost price to ascertain selling price.
   (*b*) The percentage of expenses to turnover.
   (*c*) The percentage of net profit on turnover.

   Cost of goods, £10,000 ; selling expenses, £7,500 ; goods sold for £20,000.
8. A proprietor of a business has premises valued at £5,000 and stock for which he paid £3,000. He turns over his stock five times annually, making 20 per cent on his sales each time. What percentage ratio does his annual profit bear to his capital?

ABBREVIATIONS USED IN WAREHOUSING

Adv.	Advice
Art.	Articles
Asst.	Assistant
Ass.	Assessed
Bdle.	Bundle
Bg.	Bag
Bkt.	Basket
Brit.	British
Brl.	Barrel
B/s	Bags ; bales
chges.	Charges
Ck.	Cask
Cts.	Crates
Ctge.	Cartage
Dept.	Department
Doz.	Dozen
D.W.	Dock warrant
D/W	Dead weight
d/o	Delivery order
Entd.	Entered
Exd.	Examined
G. gr.	Great gross (144 doz)
hgd.	Hogsheads
No.	Number
n/m	No marks, not marked (bales)
o/c	Overcharge
O.R.B.	Owner's risk of breakage
O.R.C.	,, ,, chafing
O.R.D.	,, ,, damage
O.R.F.	,, ,, fire
O.R.L.	,, ,, leakage
Sk.	Sack
T.	Tons ; tare
W.B.	Warehouse Book
W.W.	Warehouse warrant

SECTION VIII
COMBINES AND MONOPOLY

CHAPTER LVII

THE THEORY OF MONOPOLY

INTRODUCTION.—At the present day, industry is influenced enormously by combinations which restrict individual freedom to a great extent. This is especially the case within the sphere of commerce, where they are the means of compelling the merchant either to subject himself in a passive manner to their power, or to join these organisations as an active member. In fact, there is no section of industry so influenced by combination as that of commerce. Hence, a knowledge of its influence forms an essential part of the study of Commerce.

It has been seen that free competition causes a tendency towards normal price; that is to say, price is fixed at the point at which demand is just sufficient to carry off the available supply at the supply price. The absence of such freedom of competition may cause a price different from, and usually higher than, the normal price, which is known as *monopoly price*.

Monopoly is usually due to combination on the part of the leading producers, in order to control the whole of the supply of a particular commodity, so that the supply can be increased or decreased at the will of the monopolists.

Thus, a monopoly means a control over the supply of any particular commodity, and may be either—

(*a*) Complete; or (*b*) Partial.

COMPLETE MONOPOLY.—If the monopoly is complete, as in the case of a patented article, where the owner of the patent has the sole right to produce the commodity, then the price is usually fixed by a calculation, that if x units of the article—each made at a cost of z—can be sold at the price of y each, then y will be so fixed as to make $xy - xz$ as great as possible (i.e., $xy - xz$ = the maximum profit).

In other words, the monopoly price is so fixed as to yield the maximum net profit, neither higher nor lower, since too high a price will cause a falling off in the demand.

MONOPOLY PRICE.—Let the article be one which is produced under the law of increasing return, but subject to monopoly, such as a patented fountain pen. If the owner of the patent has the sole right to produce the pen, it follows that the greater the output of the pen the smaller will be the cost per unit of production, so that there may be a supply price and demand price curve, as shown in the diagram on page 605. If OX^1 pens are produced, it is quite possible that when more pens are made, as, for example, at OX^2, the price may be lower and the profit greater. This will depend upon the shape of the curve as to which price will pay best to the monopolist. The total cost of making OX^1 pens will be OS^1; the total receipts will be OD^1 after selling the product. It is possible that if OX^2 is made at a cost of OS^2 and sold at OD^2, then the profit will be CD^2. This is represented by the shaded area in the diagram, and is larger than the shaded area BD^1. Hence, it follows that it is possible for the monopolist to charge a lower price and still make a higher profit.

The monopolist has usually to find a price where, from the price of the article multiplied by the number of articles he sells is subtracted the cost of making each article multiplied by the number of articles he makes, the difference will be the maximum. In other words—

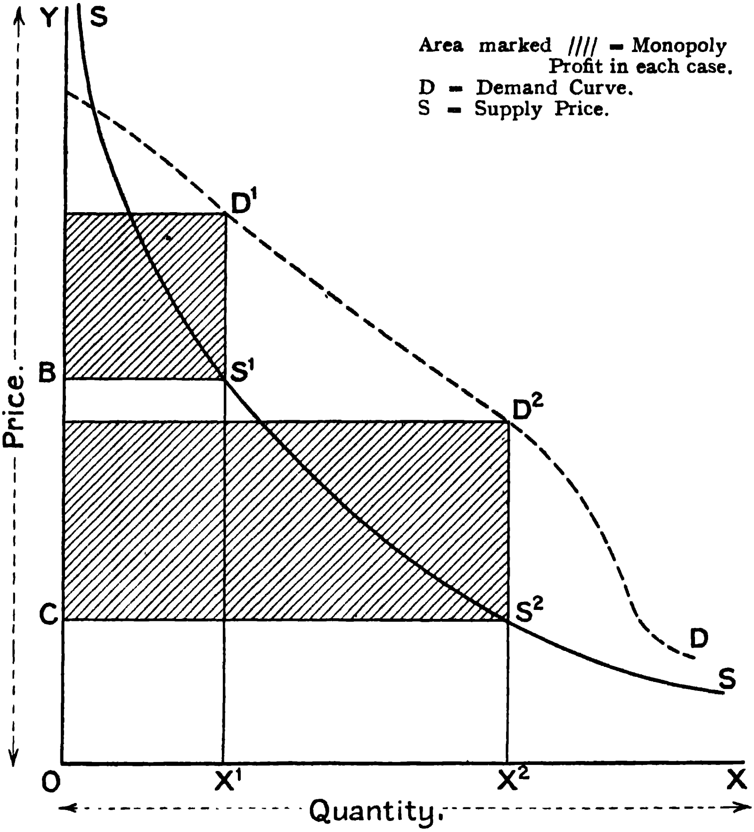
(Price of Article × No. of Articles) –
(Cost of Production per Article × No. produced)
= Maximum Difference.
= Monopolist's Profit.

Wherever there is a distinct increment in gain to be found in combination, the tendency to monopoly will assert itself. The monopoly price will be fixed by the monopolist, and may be either—

(*a*) The price which, in the long run, yields the greatest profit to the monopolist, or

(*b*) The price which the monopolist fixes after a careful investigation of the circumstances.

The monopolist's power, however, is limited chiefly to supply, and he exercises but little control over demand. It is true there are



few instances of monopolised demand, but as a rule the power of the monopolist is based upon the fact that he can increase or decrease supply at his wish. A case of monopolised demand is to be found in the economic history of the seventeenth century, when the Government passed an Act compelling every corpse to be buried in wool. Again, in modern times, vaccination has been insisted upon by the Government, thus creating a compulsory demand for vaccine lymph.

Partial Monopoly. If the monopoly is based solely upon trade reputation, and is, therefore, only a partial one, the holder of the monopoly has to take care not to screw up the prices too high. If a large firm of cutlers has a great reputation for making scissors

and razors, they may charge more than other people, because they are charging for their name. If too high a price is charged, however, they will damage themselves in two ways—

(1) They will tend to lose their customers.

(2) Other competitors will be patronised who are able to supply a commodity of equal quality.

In reality, combinations of producers are monopolies. If it is agreed by the members of the combine that a particular article shall not be sold under a certain price, then a monopoly is established. The combination can work a monopoly as long as it is a strict combination, but it very often breaks down. Combinations between large companies having a large amount of fixed capital are rarely maintained, since the temptation to break the monopoly agreement proves too strong for some of the members. One of them may break the agreement, because he believes he can undersell the combine and thus get most of the trade for himself.

ESSENTIAL CONDITIONS OF MONOPOLY.—When a combination tries to keep out competition, the difficulty increases with the *portability* of the article. The confectioners of a certain town may agree to refuse less than, say, 6s. per dozen for strawberry ices, because they cannot be readily imported from a distance. A combination might also succeed in bread, but it would not be successful in calico because of its easy portability. The conditions under which a combination may most easily be established and maintained are as follows—

(1) All the suppliers to the particular market must be included.

(2) The combination must be strong enough to punish all delinquent members.

(3) The commodity must be in urgent demand.

(4) There must be difficulty in obtaining substitutes.

(5) The commodity must be difficult to transport. No other market must be available to the consumers.

According to John Stuart Mill, it is a limitation of supply which is the essence of monopoly; but to this may be added unity of action, producing a limitation of supply, which, in turn, gives rise to an exclusive control over the article and, therefore, over price. Hence—

MONOPOLY = UNITY OF ACTION + Limitation of Supply
= Control over Article and Price.

Whether the control is conferred by a Government or not is immaterial, for it is the unity of control that sets up a monopoly.

Examples of monopolies are railway undertakings, patents, the Post Office, etc. A partial monopoly does not mean that there is a partial control over the commodity dealt in, but that the control is exercised over a part only of the supply, and that the part of the supply controlled is not large enough to gain control over the whole field. It must also be noticed that the mere size of a business does not confer monopoly. The South Metropolitan Gas Co., for instance, held a monopoly; but the Army and Navy Stores, which is an equally large concern, holds no such monopoly. The gas companies in London had districts assigned to them, so that they were under their control; but in the case of a large stores there is no such monopoly, because there is no part of London in which they have complete control of the commodity.

CLASSIFICATION OF MONOPOLIES.—Monopolies may be classified according to the owner of the monopoly, such as public monopolies owned by a political unit (e.g. the match-making monopoly of the French Government); or private monopolies owned by, and the benefit accruing to, a private person. They may be further classified according to the source of the monopoly power, so that the following division results—

I. Social Monopolies. These are the result of social arrangements, and express the real will of the society. They are general welfare monopolies, such as copyrights, trade marks, and fiscal monopolies. The legal and medical professions are also monopoly controlled as regards admission by the Inns of Court, the Law Society and the British Medical Association.

II. Natural Monopolies. These are subdivided into—

(*a*) Those arising from a short supply of raw material (e.g. limited supply of anthracite coal or of petroleum).

(*b*) Those arising from the nature of the business (e.g. railways, telephones, gas and electricity).

III. Secret Monopolies. Monopolies arising from simple secrecy are more important than one is generally apt to suppose. There are firms that do not care about patenting their secret processes, because they know that the patent, when published, may be imitated without being actually infringed. Hence, a good many

firms in the possession of secret processes make it clearly understood among their employees that if any information concerning the secret process is imparted to third parties, they will be instantly dismissed.

Another classification of monopolies is that which has reference to their position in the market (i.e. buyers or sellers); they may also be classified according to area (e.g. local monopoly, such as the water supply of a city; national monopoly, as in the case of the patent law of a country; universal monopoly, as in the case of the control of petroleum).

CONTROL OF MONOPOLY.—Although perfect monopoly is almost unknown in the sense of one supplier controlling the total output, there are numerous examples of partial monopolies of a purely local character. In certain cases it is desirable that monopoly conditions should prevail as, for example, in the case of gas and electricity, or in certain forms of transport. Where monopoly conditions exist, State interference and control will usually be called for in order to prevent the exploitation of the public. This control may be exercised in a number of ways—

(1) **By Price-fixing Legislation.** In this case the conduct of the business is left in the hands of private enterprise, but scales of rates and charges are prescribed by law. In this country, water undertakings are controlled in this way.

(2) **By Nationalisation.** In this case the control of the industry is removed from the hands of private individuals and is taken over by the State as a Government department. In these circumstances all operations are under the direct control of the Government, and the public may obtain redress for any grievance through Parliament. An example of this type in Great Britain is the Post Office.

(3) **By Taxation.** A monopolist may be left free to conduct his business without any direct control being exerted over his actions by the Government. The profits which he makes may, however, be subject to special taxation, thereby augmenting the revenue of the State and relieving the general taxpayer. This method may not be of general application, since it requires that the Government shall have precise information with regard to the affairs of the monopolist.

(4) **By Forming a Statutory Company.** This is a modern device which is an alternative to State nationalisation. Instead of the business being taken over and operated as a Government department, a

statutory body is formed under a special Act of Parliament. This body remains free from political interference, but remains under public control on account of the special legislation governing it. This method was adopted in the electricity supply industry and also in the various agricultural marketing boards.

THE MONOPOLIES AND RESTRICTIVE PRACTICES ACT, 1956.—Since the last war a Monopolies and Restrictive Practices Commission has been in existence to investigate near-monopolies referred to it. It has reported on a number of industries, and has advised some of them to discontinue practices considered undesirable. The above Act has now prescribed the registration of a wide range of agreements between traders which contain special terms not applicable to all customers. A special tribunal will consider the validity of these agreements.

TEST PAPER

1. "In every direction we see competition being replaced by regulation." Is this true?
2. Name, according to the degree of control over supply, two types of monopoly.
3. How does the owner of a complete monopoly fix the price of goods?
4. Explain by means of a diagram the meaning of "monopoly price."
5. To what dangers does a partial monopolist subject himself by raising unduly the price of his goods?
6. Under what conditions can a combination be most easily established and maintained?
7. The mere size of a business does not confer monopoly. Explain this statement.
8. How may monopolies be classified according to the source of the monopoly power?
9. What are the main forces which (*a*) encourage, (*b*) hinder, the growth of monopolies?
10. Combination is a marked feature of modern commercial life. Describe its forms and distinguish the aspects which are beneficial to society from those which are not so.
11. Discuss the maxim professed by railway undertakings of "charging what the traffic will bear." What does it mean?
12. "The price of monopoly is upon every occasion the highest which can be got." Comment on this statement and explain the considerations by which the monopolist is influenced in fixing prices.
13. Why has the discussion of monopoly recently acquired so much prominence?

CHAPTER LVIII

TRUSTS AND CARTELS

COMBINATIONS are known by different names, according to the form they assume, such as conventions, cartels, syndicates, trusts, rings, and corners. They may be divided, however, into two main forms—the cartel and the trust. A fixed meaning, however, cannot be applied to either of these terms, and frequently they are used interchangeably. The transitions from one type to the other are frequent, and take place in a variety of ways. New combinations are ever taking place, whilst existing ones are dissolved and then revived in a new form. Hence, it is better to refer to different combinations as of certain types, according as they most resemble the cartel form or that of the trust.

TRUST AND CARTEL COMPARED.—The main difference between the two forms of combination is the degree of independence which is left to the individual business units which go to form the combination. If a single member maintains its economic and legal independence, the combination partakes of the character of a cartel; but when such independence is lost, then the transition to the trust takes place.

In the cartel, only certain functions are centralised, and those upon the express condition that each single enterprise shall continue to exist as an independent unit. Each individual firm in the cartel relinquishes certain functions and places them into the hands of a central authority, thus securing itself against elimination by the forces of competition.

In the case of the trust, however, the whole of the functions performed by the independent units are transferred as soon as possible to the common entity, so that each is assimilated, even though it may continue to exist as a separate form in the legal sense. The effect of the formation of a trust is the disappearance of the single undertaking into a larger entity. The combination of labour, capital, and credit is effected for the purpose of increasing the power over the production and sale of the goods, and thus excluding competition from the market.

Hence, the trust goes further than the cartel. The latter aims

chiefly at the combination of enterprises in the same branch of commerce or of manufactures; whilst the former often combines undertakings in different branches of industry, such as manufactures, trade, transport, and insurance. As it expands, it takes in competitive enterprises and grows in breadth. The trust tries to unite the largest possible number of smaller firms into one complete unit, and thus increase the production and sale of the goods; further, it aims at adapting the output to the demand, at safeguarding the market against over-production, and at securing the most continuous uniformity of output and complete regulation of the price.

A further important difference between the cartel and the trust is to be found in their constitution and stability. Cartels consist of simple independent undertakings which combine, more or less voluntarily, without yielding their rights. For them, the cartel is but the means to a certain end, viz. the maintenance of their enterprise as a profit-earning concern. Such cartels are formed by contract, lasting, as a rule, for a comparatively short time; and each member remains in the cartel only so long as it offers advantages to him.

In most combinations of the trust type, there is evidenced the desire for self-sufficiency, and attempts are made by the trust to liberate itself from dependence on the producers of raw material, or on the sale of the finished goods. A trust which has undergone a considerable amount of horizontal expansion will, therefore, begin to develop in height and depth. The rolling mill, for instance, which has become independent of the steel works which hitherto supplied it with raw material, may start its own steel works; and the steel works has, again, a desire in the same direction to take up its own blast furnaces. Again, the producers of pig iron may desire to free themselves from the suppliers of coal and ore, and, therefore, purchase their own coal-mines, with coke ovens, and iron-mines; further, the trust may build its own ships, in order to become independent in regard to the transport of raw materials and of the finished products, as in the case of the American Oil Trust. Moreover, the trust may try to control the railways by buying up the shares, so that it can regulate the rates of freight in its own interest and to the disadvantage of its competitors.

The kernel of the trust is its capital, the extent of which enables

it to promote, acquire, combine, or conduct any kind of under taking. Since the capital is organised by the large banks or financial institutions, these are generally closely connected with the trust, and are thus able to control the promotions of new businesses, the granting of credit, and can assist the trust in developing new lines which are considered by them as profitable. It is therefore clear that the modern bank exercises a great influence on the whole economic life of a country, and high qualifications are required of the leading directors in the banks. To be suitable for such a position, it is necessary that a person should have a thorough acquaintance with the money market and the various branches of industry.

ORIGIN OF CARTELS.—A proper knowledge of the main characteristics of trusts and cartels entails a knowledge of their origin and aims. Cartels have, with some amount of justification, been called the "children of distress." Unrestricted competition has often led to an intolerable state of affairs, or even to the complete ruin of competing enterprises. Such competition is not always one of prices, but sometimes has reference to quality, or terms of payment, and often leads to the unrestricted production by the single business and the flooding of the market with unsaleable goods. There is only one means by which such a drawback can be overcome, viz. an agreement among the competitors themselves. Like exhausted parties in a war they conclude peace by handing over to a central depot the weapons of competition, such as the fixing of the sale price, the quantity of output, etc. As a matter of fact, most cartels have originated in times of crisis or of distress in certain branches of industry.

Periods of depression are most favourable for the formation of cartels, for employers do not care to renounce part of their independence except under compulsion. When the power of the cartel increases so that it can fix the price, the danger arises of abusing its position by raising the prices to an abnormally high level. In such a case, the object is not to secure a reasonable profit for the individual members of the cartel in return for services rendered and risks undertaken, but its aim is to enrich itself at the expense of the consumers. Hence, the cartels give up the role of acting as saviours of their members from destruction and enter upon a purely capitalistic career. Such a development on the

part of cartels is specially furthered by means of protective duties, which render foreign competition impossible and thus favour an artificial increase of prices up to the point at which outside competition can enter in spite of the duties. Even this barrier may be surmounted by the formation of an international cartel.

The imposition of duties on imported goods is, therefore, one of the best means of fostering cartels which are based upon prices; but even here there is a limit to their growth, because, by the fixing of exorbitant prices, economic forces are brought into play which lead to the destruction of the cartels.

ORIGIN OF TRUSTS.—The origin of trusts is quite different. They may be said to grow spontaneously out of the soil of the large industrial enterprises; the spirit of enterprise and the power of expansion which grow with economic success lead to the conversion of the smaller enterprise into a larger one, and, finally, to the establishment of a business on a gigantic scale. Two factors favour this process—

(1) The more an enterprise develops the greater becomes its influence.

(2) Capital flows to those concerns in which the largest capital return is expected.

It would be a mistake to say that the promoters and administrators of trusts have no other idea than that of making money in their transactions. It is the spirit of enterprise by itself, the *entrepreneur's* enjoyment of the success of his own work, the intellectual pleasure of thinking out continually new ideas and of realising them, and of assisting in the triumph of mankind over nature by new achievements that contribute to the growth of such large concerns. Last, but not least, however, must be remembered the pleasure and pride derived by the employer in the development of his personal power and reputation, for this is surely one of the reasons which push most of the promoters of trusts to their goal.

DANGERS TO CARTELS.—The constitution of a cartel is not of a firm and enduring character, and it is threatened by the following dangers—

(1) **The Failure of its Members to Keep their Agreements.** Every member is, of course, obliged to fulfil the terms of agreement and to submit to the terms and conditions of the cartel. As security

against unfaithfulness, the cartel has often nothing more than the signed agreements, which are not always acknowledged by the Courts.

The cartel is practically powerless against the secret and indirect transgression of the conditions of the cartel, which is often resorted to by delinquent members, even if agreements and terms have been most carefully and strictly drawn up so as to safeguard against such eventualities. Very often it happens that the chief cause of the dissolution of a cartel is the infidelity of its members.

(2) The Period of Duration. The cartel is always arranged for a certain period, such as a month or several months, but only rarely for a number of years. The question of the renewal of such an agreement is always a very uncertain matter. Especially during the last period do the members entertain the fear that the cartel will not be renewed, and in such a case they must prepare themselves at the beginning for such times when the cartel will be dissolved.

(3) Outsiders. The greater the participation of all enterprises of a certain kind in the cartel, the easier can it achieve its purpose of abolishing competition and of maintaining a certain level of prices.

The larger the percentage of those who do not join the cartel (i.e. the outsiders), the weaker is the cartel. For a cartel to be permanently successful, it is necessary that as many interested firms as possible should join it. However, this is a difficult matter.

In many cases, an *entrepreneur* cannot be induced to hand over important functions of his control with the simple desire of assisting other producers in the same branch of industry, and, therefore, he prefers to remain outside of the cartel until he can reap an economic advantage by joining it. There may be no necessity or compulsion to join the cartel, unless the cartel renders his position untenable by the cutting of prices in his circle of customers.

In some cases, admission into the cartel will be refused for purely business considerations. Among the competitors in any line of business are many kinds of firms—strong and weak, large and small, rich and poor. One firm may be fitted and equipped in the most modern manner, being supplied with the latest machinery and the best methods, whilst others are retrogressive. Hence, it is only natural that such weak and inefficient firms should be excluded.

TEST PAPER

1. Mention some of the different names applied to different forms of combination.
2. Into what two types may different combinations be grouped ?
3. Distinguish between the trust and the cartel.
4. Account for the origin of cartels.
5. Explain the origin of a trust.
6. Enumerate the chief dangers which threaten the cartel.
7. Which is the more enduring : the trust or the cartel ?
8. What are the conditions which favour the partial or complete abandonment of competition by undertakings which up to a certain time have competed with one another ? Name and explain briefly the chief kinds of agreement or combination which you know.
9. Explain and illustrate the difference between so-called " vertical " and " horizontal " combinations in industry. State generally the causes which have led to each of these classes of combinations.
10. Consider the circumstances under which (*a*) Trusts, (*b*) Cartels, are likely to arise. What advantages and disadvantages accrue from their institution ? Do you imagine that in the future they will become more or less general and more or less lasting ?

SECTION IX—COMMERCE AND THE STATE

CHAPTER LIX

LOCAL GOVERNMENT AUTHORITIES

NATURE OF THE LOCAL AUTHORITY.—Local government authorities are compulsory organisations subordinate to the central government, existing for the purpose of discharging the functions of government which are the particular concern of the inhabitants of a given locality. A local authority has been defined in the Finance Act, 1931, as "any body having power to levy a rate or to issue a precept to a rating authority and includes the corporation for which any such body acts for executive purposes."

The functions of local government have been defined as those "which concern life, liberty, and the pursuit of happiness." The local authority is charged with the performance of many duties which contribute materially to the welfare of the individual. These local services are on the increase, for since the First World War there has been a steady stream of legislation giving local authorities fresh powers and imposing fresh duties and obligations upon them. Neither Parliament nor the Cabinet can undertake much more work: local government is the only form of democratic control not yet over-burdened: and there is reason to expect that Parliament will impose yet further compulsory services on local authorities. The *principal functions* which these bodies now perform have been stated by J. J. Clarke in *The Local Government of the United Kingdom* (Pitman) as follows—

(*a*) Maintenance of a local legislature, with power to make by-laws which are a code of detailed instructions for the application locally of the general principles of law.

(*b*) Care of certain classes of the community, e.g. the destitute.

(*c*) Provision of arrangements for public safety.

(*d*) Maintenance of works of public convenience and utility.

(*e*) Establishment of institutions for the betterment of the community, and for the development of character.

(*f*) Management of quasi-commercial undertakings.

(*g*) Power to raise money either by a system of rating or by one of loans repayable over a period of years.

FORMS OF MUNICIPAL ENTERPRISE.—Municipal enterprises now assume a diversity of forms and show a continuous tendency towards expansion. Municipalities no longer confine themselves solely to the establishment of institutions which cannot be carried on by private entrepreneurs, but to some extent they also occupy themselves with the production or distribution of goods, that is, they create their own *public undertakings*, and thus displace the private undertaking. The following types may be distinguished—

(1) **Municipal Institutions.** These are municipal enterprises which are not administered from a purely economic standpoint, but are created for the discharge of what have been termed the "political" functions of local government. These services, whether they be exclusively for the common good, as, for example, the provision of police, the maintenance of high roads, or the lighting of the public streets, or whether they be partly for the common good and partly for the welfare of particular individuals, as, for example, the relief of the destitute and the free education of children, are paid for entirely out of the funds provided from the rates or by taxation. Certain services fall under this heading, too, even though they yield a certain revenue. Thus, a Sewage Committee which sells grease and clinkers is not regarded as a trading enterprise, in view of the fact that the functions performed are largely political, and the vast bulk of the expenditure of the department has to be met out of the rates or from taxation.

(2) **Subsidised Undertakings.** These are economic undertakings where the products or services are paid for by the consumers as such. From various motives, however, it has been decided that these undertakings need not be entirely self-supporting, but shall receive a subsidy from the rates. This course of action often occurs on sanitary grounds, as in the case of public baths, where a high charge for admission would be necessary to make them self-supporting. This would deprive the poorer classes of access to adequate bathing facilities. Another motive may be the general welfare of the community which may act as a justification for subsidising municipal dock and harbour undertakings or places of amusement in health and pleasure resorts. Another reason for which municipalities sometimes subsidise undertakings is to encourage the intellectual life of a town. It is on this ground that municipal theatres are established on the continent of Europe.

(3) Trading Enterprises. These are undertakings which are regarded as strictly trading enterprises, to be managed on a self-supporting basis. They may include such enterprises as waterworks, and tramway undertakings, in respect of which it is requisite to arrive at an accurate statement of profit and loss. Municipal trading undertakings may be monopolistic in nature or they may be faced with outside competition. The monopolisation of public utility services such as gas, water, or electricity by municipalities created but little opposition, since it was clearly in the interest of the community. It would never pay in an average-sized town to have two undertakings supplying such services, because of the large amount of capital involved and the high overhead costs. When, however, the municipality embarks upon ordinary commodity trading this justification is no longer present, and other motives must exist to warrant such intervention where a local authority comes into direct competition with its own ratepayers.

CAUSES OF DEVELOPMENT OF MUNICIPAL UNDERTAKINGS.—A variety of motives has led to the extension of the field of municipal enterprise in the sphere of economic activity. There are those who would wish to see the socialisation of all the essential services, and who regard the extension of municipal control as a step in this direction. It is, however, well recognised that the various forms of enterprise have their appropriate scheme of organisation most nearly suited to their needs, and that, amongst others, municipal enterprise plays its part. Amongst the various motives may be recognised the following—

(1) Existence of Monopoly. Certain industrial undertakings possess a strong tendency to become monopolies owing to the nature of their business. Some of these industries, such as railways, telegraphs, and telephones are national in their scope; others, such as water and omnibus services, are local. All industries of this type require the investment of a large amount of capital throughout the area which they serve, in order to distribute the product or service which they supply. As soon as one such undertaking has laid its mains or its lines in a district, no direct competitor is likely to enter the field, as it is improbable that the population of the district could support two similar undertakings. One reason for which water, gas, and similar services have frequently been municipalised in preference to adopting an alternative method of control lies in the

fact that they all involve certain rights in connection with the public streets Mains and lines must be laid and kept in repair, and this cannot be done without pulling up the streets and obstructing traffic, and many local authorities feel that this should be under their entire control. Again, many of these services are more or less necessities, and to a very large extent the body of consumers coincides with the body of ratepayers. This being so, the local authority for the purpose of providing water and tramways may be regarded as a society of consumers who unite to provide themselves with certain necessities of life with a view to saving the profits of the middleman.

(2) Capital Expenditure. Many enterprises may be municipalised, since heavy capital expenditure is called for which will yield no revenue for a long time. This argument applies most strongly to the supply of water, where considerable foresight is required. In a year or two the output of most ordinary undertakings can be doubled or trebled, but to secure an additional supply of water to a town ten or more years of continuous work may easily be required. This means that for several years a large amount of capital will be unproductive, thus seriously affecting the profits of the undertaking and making boards of directors very reluctant to enter upon any large scheme. Again, in the case of transport facilities, for example, it may be necessary that extensions of an unremunerative kind shall be undertaken for social reasons. Thus it may be desirable to offer special facilities to certain parts of a town with a view to inducing people to live farther out, and relieving congestion in the centre. This may be done by charging especially low fares on certain routes.

(3) Public Interest. In many cases the most obvious reason for embarking upon municipal undertakings is simply the fact that there is an unusually great public interest shown in this or that service, and it is believed that the best interests of the public would be served by a municipal undertaking. In industries closely associated with the public health, where reliable quality is essential, and where inspection cannot easily be made thorough, public operation may be desirable. Thus, there is much to be said for the public provision of slaughter-houses, to which, as in Germany, all butchers are compelled to resort. In many cases, however, the appropriate remedy lies not in municipalisation, but a more rigid enforcement of regulations affecting the industry in question.

(4) **Raising Revenue.** A further reason for municipal trading operations is to secure for the local authority the profits resulting from them. One reason why many local authorities are anxious to obtain sums in relief of the rates is that the great bulk of the revenue has to be obtained by direct levies in the form of rates on land and buildings. Consequently, if some revenue can be obtained from what amounts to indirect taxation, the burden is not felt quite so severely. If people pay a slightly higher price for their water or travel a somewhat shorter distance on a municipal vehicle for threepence, they do not feel it in the same way as if they had to pay higher rates.

(5) **Cost of Management.** Another consideration which may lead to an extension of municipal trading is the saving in the cost of management in the case of public, as compared with private, ownership; there are no directors' fees to be paid, and the salaries of municipal officials may be lower than those of private undertakings. The saving, however, may easily be more apparent than real. The fees paid to directors of companies are often small when compared with the increased earning capacities of the companies due to their efforts. On the other hand, the unpaid aldermen and councillors who constitute the trading committee of local authorities may contribute little or nothing to the success of the undertaking for which they are responsible, and sometimes may even cause it to be less successful than if the management had been left entirely in the hands of the officials. Again, it is frequently alleged that local authorities fall into the temptation of over-staffing their undertakings.

REVENUE AND EXPENDITURE.—Municipal administration embraces the methods by which the means are raised for the carrying on of the public organisation, and, further, the manner in which these means are spent. Since the municipality is not, strictly speaking, a trading concern, it has to procure the means necessary for its management in a different manner from the private business. As the municipality is a compulsory organisation supported by the State, it is in a position to force its members to contribute according to the needs of the municipal administration. The principal sources of revenue are—

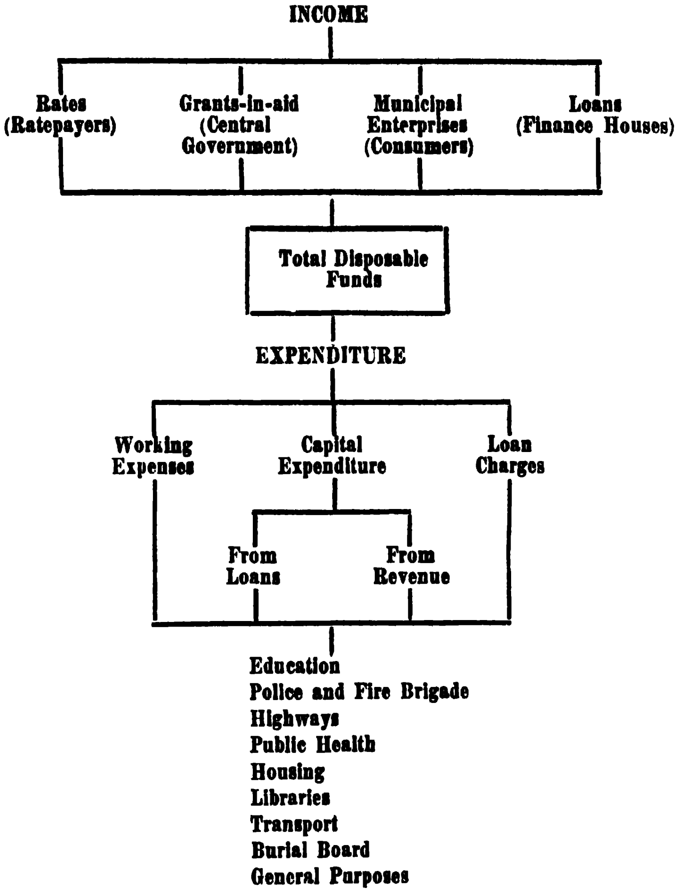
(1) **Rating.** This is a form of local taxation the proceeds of which are applicable to local purposes of a public nature, and which is

leviable on the basis of an assessment in respect of the yearly value of property. The power of municipalities to levy rates is restricted and regulated by the State under the Rating and Valuation Acts. Furthermore, although local expenditure is decided upon by local authorities as far as matters of secondary importance are concerned, the State decides upon the principal items. Local rates have two characteristics which make a study of their effects on industry more necessary than in the case of national taxation. The first is that rates enter into the cost of production. Rates are payable whether a profit is earned or not; they therefore form part of the fixed costs which must be allowed for in the price. The second is that rates vary, often considerably, between different areas, and may have effects upon the localisation of industry.

(2) **Grants-in-aid.** This is a subvention payable from the Exchequer of the United Kingdom to a local authority in order to assist it in the execution of some or all of its statutory duties. The subvention may be an isolated payment, but is usually recurrent or annual. It may be a matter of statutory obligation or dependent upon the recurring decision of the Minister in charge of a particular department. It may be unconditionally of fixed amount, or, variable according to the circumstances of the time. Most important of all, its variable amount may be dependent upon the growth of population, or of a particular section of it, on the amount of some particular service, on the number of officers appointed, or the sum of their salaries, on the expenditure of the receiving authorities, on the efficiency of its work, or some other condition. The principle of transferring a portion of the cost of locally administered services to national taxation has been adopted in recent years on an increasing scale. This is justified by the fact that many functions of local authorities are national services locally administered. The grants have had the advantage of relieving the rates, while there has remained on the local authority sufficient responsibility to secure economical administration. Further, the control gained by the Government owing to its power to withhold the grant has been of great benefit in securing a higher standard of efficiency.

(3) **Revenue from Municipal Undertakings.** As already indicated, many forms of municipal activity create a revenue. In certain cases, this revenue may meet but a small fraction of the total cost of the service, whilst in other instances it may more than cover it. In the latter

INCOME AND EXPENDITURE OF A MUNICIPALITY



case, the municipal trading undertaking may show a surplus of profit which can be utilised for the relief of rates. In certain cases, however, an exaggerated value is placed on revenue from such sources, since the so-called surplus is a fictitious one. It may be obtained as a result of making inadequate provision for depreciation, or by reason of the fact that other departments of the municipality are giving services to the trading undertaking either for nothing or much below cost.

(4) **Loans.** A local authority may raise money by borrowing in order to undertake works of public utility which could not be paid for out of current revenue without imposing an onerous burden upon the present body of ratepayers. Except in certain special cases, local authorities have no general authority to raise money by way of loans. Their borrowing powers are limited to the provisions of statute law, which also regulate their loan procedure. In giving sanction for borrowing the Department concerned stipulates the period in which the loan must be repaid, the number of years approximating as closely as possible to the estimated minimum life of the work upon which such expenditure is being made. The obligation is, therefore, upon the corporation to set aside each year enough money which, accumulated at compound interest, would produce the amount borrowed at the end of the period stated.

TEST PAPER

1. Name the chief bodies that administer the local government of England and Wales. What are the principal functions which these bodies perform?
2. Show clearly the type of enterprise that might be efficiently organised by a municipal corporation, and give three concrete examples.
3. "A variety of motives have led to the extension of the field of municipal enterprise in the sphere of economic activity." Specify these motives.
4. Discuss the relative advantages and disadvantages, from the social point of view of municipal and private enterprise in industry. Illustrate your answer, as far as possible, by reference to any enterprise of which you have made a special study.
5. What are the principal sources of revenue of a municipality? For what main purposes is this revenue utilised?
6. Draw the diagram on page 639 and explain its meaning.

CHAPTER LX

Central Government Departments

FUNCTIONS OF GOVERNMENT.—In 1776 Adam Smith wrote his great work on *The Wealth of Nations*, which was intended to argue that the functions of the Government should be very strictly limited. One aspect of his writings taught that every man may and every man must live to mind his own business. According to him, there were only three ruling functions for the Government to attend to—

(1) The protection of all its citizens from external force or fraud; that is to say, the maintenance of an army and a navy to protect each community against the possible aggression of some other community.

(2) The protection of each against force or fraud of others; that is to say, the maintenance of law and order, the administration of justice and of an effective system of police.

(3) The provision of other conveniences. What it is the interest of everyone to attend to, generally leads to no one attending to it. For example, it is to everybody's advantage that there should be lighthouses round the coast, and still it is no particular person's duty to provide such conveniences. Therefore, it is the duty of the Government to interfere and make the provision.

John Stuart Mill endeavoured to classify the functions of Government into two great classes—

(1) The necessary; and

(2) The optional.

This classification is not very definite, for the necessary functions of Government simply mean the duties which every civilised community has, in fact, undertaken. Among these are the maintenance of law and order, army and navy, etc.; whilst the optional functions are those which, as a matter of fact, sometimes are and sometimes are not carried on by the Government. An example of an optional function is the maintenance of the railways, because some countries carry on the railways as Government undertakings, whilst others leave them to private enterprise. Sometimes a function which has been regarded as necessary passes into the optional class,

and vice versa. For example, almost every authority regarded the function of coining money as a necessary function, but this was challenged by Herbert Spencer, who held that the work of minting would be better done by private enterprise.

Of late years, England has tended to entrust a great many more functions to the Government than was formerly the case. Within the last thirty years the tendency has undoubtedly been to look more and more to the extension of Governmental interference, and this is especially the case in the realm of Industry. The control of industry by the Government during and since the First World War is too well known to require further comment.

The State may consider it expedient to make regulations to control business from the point of view of any one or more of the various interests concerned, and those interests are all more or less antagonistic to each other. The chief of these are—

(1) The investor who has capital in a particular kind of undertaking;

(2) The worker employed in it;

(3) The customer who looks to the undertaking for the supply of certain goods or services; and

(4) The community as a whole whose interest, though less direct, is not necessarily less important.

At various times and in various ways, the State has intervened in the interests of some one or more of these different classes. Directly such intervention takes place, there is an interference with the freedom of contract; otherwise the intervention is of a purely ornamental character.

Because all intervention must interfere with individual freedom of contract, it is sometimes argued that it must necessarily be a bad thing in the long run, although this does not always follow. Freedom of contract suggests a certain amount of option to both contracting parties to deal elsewhere, and in England it is usually considered inadvisable to interfere with this freedom unless the limits of the consequences of the intervention can be foreseen. It must be remembered, however, that competition is not altogether an unmixed good, but that it is attended with certain disadvantages. There is in many cases a tendency to increased prices, since competition involves a certain amount of waste due to friction between the competitors, so that, in

many cases, something may well be said in favour of restricting competition.

GOVERNMENT DEPARTMENTS.—State control may be exercised through Government Departments or through local authorities. The most important Government Departments which exercise any control over commerce are as follows—

(1) The Board of Trade.

(2) The Ministry of Housing and Local Government.

(3) The Ministry of Transport and Civil Aviation.

The Board of Trade. This department of the Government is the nearest approach in England to a Ministry of Commerce, which has so often been mooted.

Trading between this country and other countries involves the making of agreements and treaties at Government level. This individual businesses could not do, and it falls to the Board of Trade to represent British business interests in Parliament in securing these arrangements. The Board also has sections dealing with particular groups of industries, and with different countries or groups of countries, watching and helping to further the interests of these industries or of trade with these areas. It has Trade Commissioners and representatives in all countries with which we have diplomatic relations to give assistance to British business men visiting those countries or requiring information about them. These agents report back to the Board information concerning the economic trends of those countries, and also opportunities for import or export business which might be exploited by our industries and commercial concerns.

A wealth of information about trends in the home market and economy is also collected by the Board, and its Statistics Division sorts and presents this information through the *Board of Trade Journal*, issued weekly, and various other Government publications. In fact the raw materials of a vast amount of market research are gathered and presented for the information of business men in this country through these publications.

Since the last War when there has been currency regulation and trade has been deliberately channelled to nurse an unfavourable balance of payments position, the Board of Trade has been the agency for licensing imports and exports to make sure that the natural trends of trade do not aggravate our financial situation *vis-à-vis* the rest of the world. At the same time there has been a great need to

export in order to keep our payments situation as near balance as possible, and the Board has greatly assisted in finding export markets, negotiating with the countries concerned and encouraging in every way the establishment of such trade. The Export Credits Guarantee Department has been set up as a branch of the Board to help British business to break into new export markets, and it gives insurance cover to remove some of the risks of such new markets over and above those ordinarily carried by the commercial insurance companies.

It is obvious that the activities of many separate businesses and industries in overseas trade will need some co-ordination at a high level if the country's interests as a whole are to be served. This has always been necessary, but has become a much more important function in the last few decades with the increase in competition from other countries, the building of tariff walls by countries to protect their own industries and discriminate against others goods, and the loss of markets and productive power resulting from the two world wars in which we have been engaged. This country has since Industrial Revolution days been a large-scale importer of foodstuffs and raw materials, and an exporter of manufactured goods. The quantity and value of imported goods has for most of this time exceeded the quantity and value of our exports, but the relatively higher value of our finished goods over the materials we imported, the investments we made abroad, and the services (shipping, insurance, banking, etc.) which we rendered to other countries as the main commercial centre of the world, balanced out this discrepancy and gave us a surplus up to the First War World. Since then, and particularly as a result of the two wars, our position has changed drastically. Our foreign investments were largely sold to pay our way during the wars. Our traditional markets found other sources of supply, or themselves became manufacturers of the goods we formerly supplied. Our services to other countries declined as other countries developed shipping, banking and commercial services. Lastly, the goods we buy, raw materials and foodstuffs, have risen considerably in price, while the manufactured goods we sell have, as a result of much more intense competition in supply, fallen relatively. This has meant the development of a serious balance of payments position, and we have had to foster the exports of new goods to new markets and to direct these exports particularly to the countries with

which our financial position was most adversely affected. It is in this task that the Board of Trade has vastly developed its services, and a much closer relationship between business men and the Board has resulted from the realisation that the interests of the country as a whole and of individual businesses coincide in this respect.

The principal sections of the Board of Trade are as follows—

The President and Secretariat and the Parliamentary Branch are the liaison departments between the Board and Parliament.

The Commercial Relations and Exports Department is responsible for the treaty relations and negotiations between departments to facilitate our trade with other countries.

The Commodity and General Division concerns itself with export services, with U.K. tariff policy and with representation of this country at Exhibitions and Fairs here and abroad.

The Industries and Manufactures Department is concerned with import policy and licensing, investment policy and research for home industries, standards of weights and measures, and has a number of sub-departments concerned with particular industries.

The Insurance and Companies Department and Bankruptcy Department is responsible for the administration of the Companies Act, the Assurance Companies Acts and the affairs of insolvent firms and individuals. The Companies Registry at which all joint-stock companies must be registered is a branch of this department.

The Administration of Enemy Property Department is still clearing up debts between this country and the countries with which we were at war, and the administration of goods and funds seized from nationals of these countries during the war.

The Statistics Division is the clearing house for the vast amount of information gathered by the Board about internal and external trade and sees to its publication in useful form for business men. It administers the censuses of population and of production and distribution and compiles the various price indices used as barometers of trade and of cost of living.

There are also various administrative departments such as the Finance, Solicitor's, Establishment and Information divisions. There are regional offices of the Board in the main provincial cities so that the services of the Board are available in all parts of the country.

There are a number of other organisations assisting British businesses with which the President of the Board of Trade is particularly

concerned although they are not administered by the Board. Examples of these are the British Institute of Management, the British Productivity Council, the British Travel and Holidays Association and the Council of Industrial Design.

MINISTRY OF HOUSING AND LOCAL GOVERNMENT.—Through the Ministry of Housing and Local Government, which took over (among other things) some of the functions formerly performed by the Ministry of Health, there is a certain amount of intervention, direct and indirect.

The direct (i.e. that which is exercised by the Ministry of Housing and Local Government itself) is, primarily, the financial control over local authorities. In particular, the local authorities can borrow nothing without the sanction of this Ministry, and, in many cases, the local authorities have to submit their accounts to auditors appointed by it, who go through them with a view to seeing that everything is in order; and particularly in order to see that nothing has been spent or borrowed without the necessary permission having first been granted. If there were no such safeguards, there might be serious abuses.

Indirectly, the Ministry of Housing and Local Government, working through local authorities, operates in various ways which certainly impose restrictions on business. One example is the administration of the *Shops Acts*.

MINISTRY OF TRANSPORT.—The *Ministry of Transport Act*, 1919, established a Minister of Transport for the purpose of improving the means of, and the facilities for, locomotion and transport. There were transferred to the Minister all powers and duties of any Government Department in relation to (*a*) railways; (*b*) light railways; (*c*) tramways; (*d*) canals, waterways and inland navigations; (*e*) roads, bridges, and ferries, and vehicles and traffic thereon; (*f*) harbours, docks, and piers. The Minister may establish, and either by himself or through any other persons may work, transport services by land or water. He also administers the Road Fund, a fund kept separate from the country's main revenues, fed by the proceeds of taxation of motor cars, and devoted to the upkeep of the roads. Under the Road Traffic Act, 1930, control of district omnibus services is vested in the Traffic Commissioners of the Ministry. The Minister of Transport is responsible for appointing the members of the British Transport Commission which was

established under the terms of the Transport Act of 1947. Under its more comprehensive title of Ministry of Transport and Civil Aviation the Ministry is now responsible for the control and general supervision of all matters relating to civil aviation.

NEW GOVERNMENT DEPARTMENTS.—The outbreak of war in 1939 made it necessary for the Government to control the distribution of food and materials and as a result new Government Departments came into existence. The Ministry of Food was set up in 1939 and was responsible for controlling the buying and distribution of foodstuffs whilst rationing was in force. The requirements of war led to the setting up of the Ministry of Supply which bought and stored raw materials such as metals, cotton, wool, etc. The Ministry of Fuel and Power is responsible for the supply and distribution of petrol, oil, electricity, gas, and other sources of power. The Minister of Fuel and Power is responsible for appointing the members of the National Coal Board, the Central Electricity Authority, and the Gas Board. The National Insurance Scheme which includes Industrial Injury Insurance is administered by the Ministry of National Insurance. The Scheme came into full operation on 5th July, 1948.

STATE REGULATION OF ACCOUNTS.—The next aspect of State control is with regard to the statutory provision for the preparation and publication of accounts by certain undertakings on uniform lines. This provision is spread over a variety of different kinds of undertakings without any very definite underlying principle being observable. Uniform accounts have been required in the case of railway companies, gas companies, most water companies, electricity companies, insurance companies, building and friendly societies, and the smaller local authorities. In some cases, the precise form of accounts is embodied in the Act of Parliament, but in other cases the Act provides the authority which is to decide what the form is to be from time to time. Thus, in the case of insurance companies there is a statutory form.

In the case of building societies and friendly societies, the Registrar of Friendly Societies decides what the form is to be; and in the case of local authorities it is decided by the Ministry of Housing and Local Government. The appointment in this manner of some prescribed authority to modify the form from time to time is probably the better method, for there is more chance of the form being kept reasonably up to date.

TEST PAPER

1. What, in your opinion, are the functions of Government?
2. Discuss, from an economic standpoint, the circumstances which render an industry suitable or unsuitable for public management.
3. In what way has the function of the Board of Trade in assisting business men increased in importance in the last few decades?
4. State in a general way the chief functions of the Board of Trade.
5. What are the functions of the Commercial Relations and Export Department of the Board of Trade?
6. Mention some of the cases where the State regulates by statute the preparation and publication of accounts.
7. Give a brief account of any measures known to you by which, in recent times, the Government has intervened for the purpose of promoting or facilitating the trade and industry of the country.

CHAPTER LXI

Consular and Other Government Services

THE rise of the Consular service coincides with the beginnings of commercial intercourse among European peoples. The first reason for the establishment of such an institution was the need for the protection of persons engaged in the conduct of trade with overseas factories and trading centres, and from this there has gradually developed the present significance of this institution.

DUTIES OF A CONSUL.—A Consul is a person appointed by his Government to reside in some foreign country, in order to watch over and further the commercial interests of the nation he represents. Every Government maintains a consular service and has a Consul-General in each foreign country of importance, with Consuls and Vice-Consuls in the principal commercial centres. In Commonwealth countries Trade Commissioners or Trade Correspondents perform the commercial functions of the Consul. The British service was reorganised after the First World War. From this time greater stress has been laid on the commercial side of its work. Entrance to the service is by competitive examination. Prospective candidates must first of all appear before a board of selection which meets at the Civil Service Commission, 6 Burlington Gardens, London, W.1, in May of each year.

A British Consul helps to protect the interests of British subjects who may be residing in his district. He is expected to assist them if tried for offences, and to see that they are not inhumanly treated on being convicted. He has power to make inquiry upon oath concerning all offences committed by British seamen on the high seas, and to give assistance to shipwrecked and unemployed seamen and other destitute persons, and to provide them with the means of returning home. He issues passports to British subjects, celebrates marriages between them, and generally does his best to further their interests. Some of his most important work consists in collecting information regarding the trade and the commercial needs of his district, so that British traders may be able to open up or develop trade with that district. Some of these reports, which are issued by the Foreign Office in conjunction with the

Commercial Department of the Board of Trade, are documents of great value and of interest to all who are engaged in commerce.

In business transactions, the Consul has the powers of a Notary Public and of a Commissioner for Oaths. He is also empowered to impress documents with British stamp duty where necessary; and any British subject who gets into difficulties—legal or otherwise—in a foreign country, may appeal to the nearest British Consul, when he may rely upon receiving such assistance as may be possible.

The principal trade document with which consuls and vice-consuls are concerned is known as the *Consular Invoice*. This is a special invoice form provided for the use of exporters. On the back is a declaration of accuracy which must be sworn to before the consul of the importing country, signed in his presence, and countersigned by him. This form is completed in triplicate, one copy being for the consul, one for the shippers, and one for the Customs authorities at the port of entry of the goods. The latter copy assists in the assessment of tariffs, and therefore facilitates clearance of the goods enumerated on it. It is often associated with a certificate of origin required to prove the origin of goods where the importing country imposes a preferential rate of duty on goods coming from certain countries. A fee, varying according to the value of the goods and the country concerned, is charged by the Consul for legalising the invoice. This fee is known as *Consulage*, and is also charged by the Consul for the performance of certain other duties connected with his office.

EXPORT CREDIT SCHEMES.—Another development arising out of the war of 1914–18 is the assistance that the Government gives to industry in times of great financial crises. This has taken the form of export credit for which the first provision was made in 1919. The finances and currencies of Europe were in a more chaotic state than the commercial men of that generation had ever known, and external aid was required to facilitate the resumption of trade with countries whose commerce and industries had been crippled by the war. Under the original scheme advances were made to exporters whose trade with such countries would otherwise be at a standstill, but the foreign importers were required to find approved collateral security.

In 1921 this scheme was replaced by a system extended to all countries except Russia, under which the payment of a proportion of bills of exchange was granted by the Exports Credit Department. Devised to meet still rather abnormal conditions of trade, the scheme was by no means simple, but it undoubtedly brought to this country a certain volume of business, which would otherwise have been placed elsewhere.

In 1926 a new scheme was instituted on the recommendation of a committee of bankers and others appointed to examine the general question of credit insurance. Guarantees are given to exporters in return for a premium and afford protection against the main risks of overseas trading. The Export Credit Guarantees Department is permitted under the Export Guarantees Act, 1949, to commit itself up to £500 million in covering exports of consumers' goods on short credit and the outright sale of capital goods. The E.C.G.D. (Contracts) Policy insures an exporter against loss up to 85 per cent if the foreign buyer becomes insolvent or if payment is not made in twelve months, and up to 90 per cent against "transfer risks." The latter covers the exporter against non-payment if a foreign government imposes exchange restrictions. It also helps to cover the cost of market research undertaken before commencing business in a new market.

ECONOMIC ADVISORY COUNCIL.—This standing body, presided over by the Prime Minister, was introduced in 1930 to advise His Majesty's Government in economic matters. Its chief purpose is to make continuous study of developments in trade and industry and in the use of national and imperial resources, of the effect of legislation and fiscal policy at home and abroad, and of all aspects of national, imperial, and international economy with a bearing on the prosperity of the country. The Council may initiate inquiries into, and advise upon, any subject falling within its scope, including proposals for legislation. The reports and work of the Council are confidential unless it advises the Prime Minister otherwise.

AGRICULTURAL MARKETING BOARDS.—These represent an attempt on the part of the State to plan the marketing of certain agricultural products with a view to eliminating the wide difference in price as between the producer and the consumer. The defects of the agricultural marketing system have been the subject of frequent

comment by official committees of investigation. Thus, the Linlithgow Committee stated—

Farmers, for the most part, are men in a small way of business, and even when farming on a somewhat large scale the produce which they have individually to offer at any one time is an insignificant contribution to the total supply. Sales of such products as grain and livestock are intermittent and not of daily, or even weekly occurrence, so that the marketing side of their business, though of primary importance, takes a second place as compared with the more immediate problems of farm management.[1]

In an attempt to place this side of agricultural activity upon a firmer basis, the *Agricultural Marketing Act*, 1931, was passed into law as an enabling measure. Under this Act it became possible for producers to mobilise themselves comprehensively for group action in the markets of this country. For this purpose the majority of the producers of a particular product could submit a scheme for regulating the marketing of it which, when approved by the Minister of Agriculture and by Parliament, became binding on the whole industry. It was, in fact, an Act to protect the main body of producers against minorities who could otherwise wreck any policy which the industry might attempt to pursue in its common interest. This Act made no attempt to regulate imports so that the consumer was safeguarded from price exploitation by the possibility of outside competition. Again, there was no attempt to control production and no promise for assistance from the Treasury. Only one scheme was prepared under this Act alone, namely, for hops, a crop already protected by heavy import duties.

In 1933 a further Agricultural Marketing Act was introduced which gave power to regulate supplies, both of imports and of home grown produce. Hence it may be said that the machinery for formulating and operating schemes for the reorganisation of agricultural marketing was provided mainly by the 1931 Act, while the inducement to use it was in the Act of 1933. Under these Acts, any persons who satisfied the Minister of Agriculture that they were substantially representative of the producers of an agricultural product in a given area could submit a scheme for regulating the marketing of that produce in that area. The product could be either primary (such as beef, hides, eggs, or oats) or secondary (such as refined sugar, canned peas, bacon, or cheese). The scheme had to provide for a register of producers of the regulated product, for a vote to be taken

[1] *Final Report of the Departmental Committee on Distribution and Prices of Agricultural Produce.*

whether the scheme was to stay in force, for the constitution of a board elected to represent registered producers, for fines and arbitration in cases of dispute, for establishing a fund by contributions from producers, and for borrowing, lending, or guaranteeing money. Power could be taken under the Act for the board to buy, sell, advertise, transport, grade, or manufacture the regulated product, and to organise statistics, research, education, co-operation, or inspection in connection with it.

One of the most successful schemes was the Potato Marketing Scheme which was introduced in 1934. It aimed at preventing fluctuations in the price of potatoes by controlling production and supplies. Each grower of potatoes had to be registered and was allotted a quota which was based on the average acreage for the last three seasons. A fine was imposed if this acreage was exceeded.

The Milk Marketing Scheme came into operation in 1933. All milk producers must register with the Milk Marketing Board which buys the milk at a fixed price and sells it to the distributors. All the milk in a particular area is pooled and each producer receives the same price. The Board sells the milk at different prices according to its use.

TEST PAPER

1. Account for the origin of the Consular Service.
2. Enumerate some of the chief duties of a Consul.
3. What services do Consuls render to Commerce ?
4. What is meant by a consular invoice ?
5. What attempts have been made by the Government to render financial assistance to traders in times of crises?
6. Explain briefly the functions of the Agricultural Marketing Boards.

CHAPTER LXII

THE POST OFFICE

TO-DAY, all civilised communities have a well organised postal system. The term "post office," however, is usually applied to the building where postal business is transacted, and in Great Britain it is used for the General Post Office in London, and also to district offices and small branch offices. In remote country districts the post office is often run in conjunction with a general stores.

HISTORICAL DEVELOPMENT.—The real beginning of the Post Office dates from the year 1512, when Sir Brian Tuke was appointed the first Master of the Post. His duty was to look after the relays of post horses maintained on the regular post roads at the King's expense. The first serious attempt to establish a monopoly for the Royal posts is contained in a proclamation of Queen Elizabeth in 1591.

A scale of postal rates, graduated by distance to cover the costs of relays of post horses, was introduced about the year 1635, when the Central Post Office was established in the City of London. In 1784 a mail coach service was organised, and for the next fifty years constituted the chief means of transport for postal matter; ultimately, it was superseded by the railway. In 1812 the postal rate for a single sheet letter from London to Liverpool had risen to eleven pence. Rowland Hill reformed this system, and in 1840 the Penny Post was adopted, the charge being governed by weight instead of by distance. In 1874 the International Postal Union established a uniform rate of 2½d. per ounce for letters to Europe; in 1898 the Imperial Penny Post was inaugurated, and subsequently extended to the United States. Subsequent increases in postal rates have been made from time to time to meet increased costs.

FUNCTIONS OF THE POST OFFICE.—The Post Office is a government department under the control of the Postmaster-General with the aid of an Assistant Postmaster-General and a staff of permanent officials. The activities of the Post Office are both numerous and varied, and students should consult the official *Post Office Guide* for a full account of its manifold services. An attempt has been made

to classify its main functions in the table on pages 662 and 663, from which it will be seen that its activities may be grouped under the following headings—

(1) Carrier or Postal Services.
(2) Banking Services.
(3) Insurance Services.
(4) Means of Communication.
(5) Agent for the Government.

(1) The Post Office as a Carrier. The conveyance of mails was the original function of the Post Office, and the postal service still remains the most important of its now very numerous activities. The matter carried consists of ordinary letters, registered letters, samples, newspapers, and printed papers for delivery both at home and abroad. More people are employed on these services than on all the other Post Office departments put together. Letters and packages have to be posted, collected, forwarded, and delivered, and the problem of the Post Office is to effect these operations as quickly and as economically as modern invention will allow. Mechanical and electrical aids have become an established feature, and the introduction of shutes, conveyor bands, lifts, and other electrical appliances has done much towards reducing the time taken for the handling of correspondence, and has minimised the labour involved in dealing with parcels and mail bags.

An innovation of 1926 was the establishment of the *Cash-on-Delivery Service.* By this service tradesmen and others may send parcels, and the price will be collected from the addressees and remitted to the sender by the Post Office. A small charge in addition to the usual postage is made, and must be prepaid by the sender. This service is much utilised by the large mail-order firms. The *sample post* is another useful service to merchants and manufacturers, since it enables them to dispatch at a cheap rate *bona fide* trade samples without saleable value.

The *Business Reply Service*, introduced in was designed to reduce the expense incurred by business houses in enclosing stamped addressed cards or envelopes, many of which were not used for the desired purpose. The sender, under licence from the Post Office, may enclose with his communication a specially printed addressed card or envelope which the client may post in the usual way, but

unstamped. The following is an example of a Business Reply Card—

FRONT SIDE OF CARD

Postage will be paid by Park Coal Co., (Cardiff) Ltd.	.	No Postage Stamp necessary if posted in Great Britain or Northern Ireland.

BUSINESS REPLY CARD
Licence No. 1747

Date........*10th Feb*.....**19** ... **Please deliver** ... ... *Five* . ..... **Tons of** ... .*M.D. LARGE* @ 164/- *per ton* **on** ....*Monday*.. .....**next.** **Name** .... *W. J. Martin,* .. .. **Address**.... ...*35 High St., Cardiff*...	PARK COAL CO. (Cardiff) Ltd., Salisbury Road, Cardiff.

REVERSE SIDE OF CARD

PARK COAL CO. (CARDIFF) LTD.
SALISBURY ROAD. Telephone No. 3098

CURRENT PRICE LIST
January 1st, 19..

GUARANTEED MAESTEG DEEP COALS
The Coal with the Certificate

		Per ton
M.D. LARGE		**164/-**
M.D. COBBLES	3 *to* 5 *inches*	**154/-**
M.D. NUTS	1 *to* 3 *inches*	**134/-**
M.D. Rubbly Small		**120/-**

SIZED ANTHRACITE

Anthracite Cobbles		**170/-**
Best Anthracite Stove Nuts	1-1¾	**252/-**
Anthracite Pea Nuts	⅝-1⅛	**182/-**
Anthracite Peas	⅜-⅝	**160/-**
Anthracite Grains	¼-⅜	**140/-**

Above prices are less 4s. per ton for cash within 14 days.

The Post Office debits the licensee with the postage due plus a half-penny fee in each case. A similar system is also available for parcels and telegrams.

In 1934 the *Railex* Service was introduced. It is intended to secure the transmission of a letter or parcel not exceeding 1 lb. in weight as rapidly as transport facilities will allow and with a minimum of trouble to the sender. Where the weight does not exceed 2 oz. the fee is 6s.; over 2 oz. and not exceeding 1 lb. the fee is 7s. The Post Office accepts a *Railex* letter and forwards it by special messenger to the railway station for dispatch by the first suitable train, informing the Post Office express delivery office nearest the station of destination of the dispatch of the letter. A messenger awaits its arrival and delivers it immediately by the quickest possible means to the addressee. This should constitute a useful emergency service.

There are now extensive air mail services for conveying mails to all parts of the world.

(2) The Post Office as a Banker. The Post Office acts as a banker in two ways—as an agency for the remittance of money and as an agency for saving and investment.

It acts as an agency for the remittance of money through its system of postal orders and money orders. These are useful chiefly where small sums are concerned. The cash-on-delivery parcel service supplements the money-order service proper, and these, together with more exceptional facilities, such as telegraph money orders, offer the public a useful range of services at low rates of commission.

The Post Office Savings Bank may claim to be an important instrument both of prudent national saving and of wise national spending. It is the bank of the people, and there is a branch in every city and town, and in almost every village in the country. Closely allied to the Savings Bank is the work of issuing and repaying *National Savings Certificates*. This scheme originated as a temporary expedient during the First World War, but it has now become a national institution. The Post Office undertook the sale of the certificates and custody of the records from the start. Unlike a Savings Bank deposit, a savings certificate is normally a long term deposit, and savings certificates are essentially investments and not savings for use at a relatively early date.

The Savings Bank also maintains a register of Government stock

and offers facilities to the small investor, particularly in connection with Savings Bank deposit accounts, for purchasing and selling these securities at a reasonable rate of commission. The facilities are, of course, not intended for the type of client who would normally transact business through a stockbroker.

(3) The Post Office as an Insurer. As an insurer the Post Office registers or insures letters and parcels for a small fee and also deals in life assurance annuities. In the *Registered Letter* Service an extra fee is charged over and above the ordinary postage. For foreign letters there is a further service, called the *Insurance Letter Service*, under which a letter may be insured for the declared value up to certain limits by payment of an extra fee.

Depositors in the Post Office Savings Bank may purchase annuities on their own lives or the lives of any person over 5 years of age. Annuities are payable in equal quarterly instalments. Thus, under this system a depositor may make provision for himself and family all under the guarantee of Government.

The Post Office is also entrusted with the sale of National Insurance stamps by which contributions to the National Insurance scheme are effected.

(4) The Post Office as a Means of Communication. In the transmission of intelligence the Post Office acts as a means of communication. For this purpose it utilises the telegraph and the telephone, of which it has a monopoly of all routes in Great Britain, and all principal Post Offices are telegraph offices. The Postmaster-General is also responsible to Parliament for the sound radio and television services of the British Broadcasting Corporation.

THE TELEGRAPH. Telegraphic communication plays an important part in the business of the world, and the extension of cables to the utmost parts of the earth has largely tended to prevent sudden and disastrous variations in the prices of the various commodities which form the staples of Commerce. For example before the war the movements of the Cotton Market at Liverpool were known as soon in New Orleans and other American cities, and in Egypt and India, as they were in other parts of England. No sooner did a rise in the price of this important raw material occur in Liverpool, than merchants in America and elsewhere made arrangements to increase their shipments so that they might participate in the profits resulting from the increased prices.

The knowledge of this in Liverpool reacted upon the market, and any attempt to force up the price of the cotton unduly was frustrated.

Like many other things, the rapid communication of news and commercial intelligence has been transformed from a luxury into an everyday necessity, and commerce without the electric telegraph would be paralysed. Inland telegrams, which means telegrams between all parts of the British Isles, are charged for at a fixed rate for the first nine words (or less), and an extra charge is made for each additional word—the message to be telegraphed may be written or telephoned. Five figures count as one word; and where a letter precedes or follows a group of figures, it is counted as a separate word. The address of the receiver is charged for, and also that of the sender, except when written on the back of the telegraph form, in which case it is "for reference only." For ordinary inland telegrams, plain language rendered as briefly as possible is used.

Foreign Telegrams may be written in plain or in secret language. For the latter purpose, several more or less ingenious works, called "Codes," have been invented, and are in general use; whilst some firms with foreign branches have private codes of their own. The object of using a code is to reduce the cost of telegraphing, since a single word may be made to represent a whole sentence; and this is an important consideration, when it is remembered that a single word often costs several shillings. International telegraph rules provide that in code language ten letters shall be the maximum allowed in one word or group, as against fifteen in plain language. In cypher five is the maximum allowed in a group, and letters only or figures only can be used. The code may be a published one or a private one for use only between the owner of the code and his correspondents, and constructed to serve the owner's own particular needs. The published codes are arranged to suit various trades, and by means of them information of every possible description may be wired.

The Use of a Code. The best known work of this kind is the A B C Code. This contains 100,564 words, alphabetically arranged and numbered so that each number also represents a certain word. Each word or number indicates a complete sentence, which anyone in the possession of the book can decipher. The sentences

which correspond to these words are arranged according to subject-matter. For example, one section refers to the acceptance of bills, another to insurance, another to the time and conditions of delivery; further, for every quantity in English or Metric weight and measures, there is a code word, as well as for the price in English money, in dollars, in marks, and in francs. If a person desires to send a telegram, he turns to the alphabetical arrangement of the sentences and their contents, notes the corresponding code word, and thus puts together the telegram. The receiver, on the other hand, refers to the alphabetical arrangement of the code-words and reads off the equivalent sentence.

An example will make this clear—

A, in London, desires to cable the following to New York—

(a) *There is an unfavourable change of market.*

He looks in the code under the word "market" and finds the required sentence with the code-word—

No. 25820 = "Malchance."

(b) *Do not commence packing until you have further instructions.*

Under the heading of "packing," the following code-word is given for this sentence—

No. 29380 = "Paddock."

(c) *What is the smallest quantity you can send?*

He looks under the heading "quantity" and finds the following code-word for this sentence—

No. 32178 = "Queatur."

Assuming that the firms A and B have agreed to use the A B C Code in their cable correspondence, A writes out the following telegram—

"B. New York
Malchance Paddock Queatur."

He could also cable 25820, 29380, 32178, as already mentioned; but since mistakes are more likely to occur with the use of figures. the words are usually preferred.

B, the receiver of the cablegram in New York, looks up the three words in the A B C Code and finds the three sentences;

instead of twenty-four words having to be used, the message has been dispatched by the use of three.

Secret Codes. Between banks and their branches and agencies. and in cases where absolute secrecy is required, cypher codes are used, which are composed wholly, or in part, of figures having a secret meaning. Every separate figure is charged as one word. and every group of five figures is charged as a word, larger groups being counted at the rate of five figures to a word, one word being added for any excess. Messages by these cypher codes can only be interpreted by the holders of the key. All communications between Governments and their representatives abroad are, when " wired," written in cypher.

The Post Office has the monopoly of all telegraph routes in the British Isles, including the Channel Islands, and most post offices are now telegraph offices. In London, cable messages are received at, and delivered from, the offices of the various companies owning the cables. In the provinces, these messages are usually taken in at the postal telegraph offices and transmitted by the inland lines either to London or to the point on the coast at which the cable company's system commences.

THE TELEPHONE. In the case of local telephone calls the caller pays for the service by placing four pennies in the special coin box affixed to the call office. With trunk calls the caller usually passes his call to the clerk at the telegraph counter; after collecting the appropriate charge this person then puts the call through the trunk exchange. When the call matures the exchange notifies the telegraph counter clerk, who informs the waiting caller to which box his call will be switched. To this branch of work a number of other services are attached, such as telephoning express letters to other towns for delivery by a special messenger. The charges in this case include the usual trunk call fee plus a mileage fee for delivery at the other end. This charge must be paid by the person originating the call.

Telex Service. This is a quick communication service whereby printed messages are transmitted on teleprinters installed at senders' and receivers' offices. It can be used for messages to the U.S.A. and certain other countries overseas. If left switched on overnight the teleprinter will continue to record messages while offices are closed.

I. Carrier Services.	The collection, carriage and delivery of correspondence and small parcels.	INLAND CORRESPONDENCE includes matter addressed to places within Great Britain and Northern Ireland. It is divided into five classes: (a) Letters; (b) Post Cards; (c) Printed Papers; (d) Newspapers; (e) Parcels. Letter Rates: Not exceeding 1 oz. 3d.; 2 oz. 4½d. and for each additional 2 oz. or part thereof 1½d. COMMONWEALTH CORRESPONDENCE includes all countries within the British Commonwealth. Territories under British Trusteeship, British Post Offices in certain countries, the U.S.A. and British Forces or Ships abroad. Letter Rates: Not exceeding 1 oz. 3d. For each additional oz. or part thereof 1½d. FOREIGN CORRESPONDENCE embraces all countries not included in the above. Letter rates: Not exceeding 1 oz. 6d. For each additional oz. or part thereof 4d. Other postal services include— (i) Late Fee Letters. (ii) Express Delivery. (iii) Railway Letters. (iv) Private Boxes and Bags. (v) Poste Restante.
II. Banking Services.	Agency for the remittance of money.	The Post Office undertakes the functions of a banking organisation in its remittance business, the postal order and money order services. MONEY ORDERS are made by one post office upon another specified post office for the payment on demand to a named person a certain specified sum not exceeding £50. POSTAL ORDERS are made by one post office upon any other post office for the payment upon demand to a named person of a specified sum not exceeding £5 (plus 11d. in affixed stamps).
	Agency for saving and investment.	SAVINGS BANK. The Post Office acts as a savings bank throughout Great Britain and Northern Ireland. Deposits may be made in every town and almost every village. The system was inaugurated in 1861 with the object of providing a safe, simple, and readily accessible means of deposit for the savings of the public. NATIONAL SAVINGS CERTIFICATES. Closely allied to the savings bank business is the work of issuing and repaying National Savings Certificates. This scheme originated as a temporary expedient during the First World War, but it has now become a national institution. GOVERNMENT SECURITIES. The savings bank arranges for investments by depositors in Government Stock and offers facilities to the small investor for purchasing and selling these securities at a reasonable rate of commission.

III. Insurance Services.	Safeguarding life and property against loss and other contingencies.	REGISTERED PACKETS. The Post Office agrees to pay compensation up to a limit of £400 for the non-delivery of inland registered packets containing bank notes, cheques, postal orders, and money orders. It also effects insurance of foreign and colonial packets, and also sells insurance stamps. LIFE ANNUITIES. Savings bank depositors may purchase annuities on their own lives or the lives of any person over 5 years of age for any sum from £1 to £300 per annum. NATIONAL INSURANCE. In connection with National Insurance Schemes the machinery of the Post Office makes collection of contributions practicable by its sale of National Insurance Stamps of various denominations.
IV. Means of Communication	The transmission of intelligence.	TELEGRAPH. The inland telegram is the most suitable means for the rapid transmission of a written message. Messages may be sent abroad by cable or wireless. The telegraph service has experienced great changes within recent times, for the methods of telegraphy have been completely altered. Morse working has practically disappeared in favour of the now ubiquitous teleprinter, an instrument with a keyboard similar to that of a typewriter. TELEPHONE. This system embraces two sections: (1) Local or Short Distance lines, and (2) Trunk or Long Distance lines. Calls can now be made to most countries of Europe and to many places over-seas.
V. Agent for the Government.	Miscellaneous Services.	SOCIAL SERVICES. The use made of Post Office machinery by departments responsible for the administration of social services has shown heavy expansion in the last decade. PENSIONS. The Post Office pays widows', orphans', and old age pensions, children's allowances, and naval, military, and air force pensions and allowances, on behalf of the issuing authorities. LICENCES. In addition to the sale of wireless and Television licences, the Post Office is concerned with the sale of many types of licence on behalf of the Licensing Authorities concerned. The most familiar to the public are the dog licence and the motor vehicle renewal licence. The list includes also game, gun and hounds licences.

(5) The Post Office as an Agent for the Government. As an agent for the Government, the Post Office issues Inland Revenue Licences and provides for the payment of Family and National Assistance Allowances, Old Age Pensions, Ex Army and Navy disability pensions, and next of kin pensions for those who fell in the wars. It should be noted that only *renewals* of Motor Vehicle Licences are issued by the Post Office, the original licence being taken out through the local government authority of the area in which the licence is desired. In the case of other licences, such as Wireless and Television licences, both the original issue and the renewal are effected through the Post Office. It also assists other Government Departments by the sale of stamps in payment, for instance, of the Entertainment Duty and also of the Income Tax. Indeed, one of the most striking developments of Post Office activities within recent times has been its gradual assumption of functions which have no connection whatever with its primary purpose, but which have been imposed upon it because its far-reaching organisation has presented the only means of carrying out with reasonable economy certain social services which the State has from time to time thought fit to establish.

TEST PAPER

1. Describe briefly the main functions of the Post Office?

2. What influence have the telegraph and the cable had upon the organisation of the market ?

3. Messrs. Thomas Holt & Co., of 128 Market Street, Manchester (Telegrams : "Holt, Manchester "), have just received 10 bags of Granulated Sugar ordered from Messrs. Joseph Taverner & Son, of 119 Great Cobalt Street, London (Telegrams : "Grano, London "). Messrs. Holt find that five of the bags have been seriously damaged by sea-water. Draft, in as few words as possible, a telegram from Messrs. Holt explaining the matter and, at the same time, ordering another five bags to be dispatched at once.

4. What methods are adopted by merchants to reduce the cost of telegraphing to places abroad ?

5. What is a cable word ?

6. "Telegraphic codes may be called the 'shorthand' of telegraphic communication." Explain this statement.

7. Write a full note on the telegraphic system as applied to commerce, both inland and foreign. State what you know about "codes." Name two important ones, and explain how a secret code may be made between an exporter in this country and his agent in Melbourne.

CHAPTER LXIII

THE INCOME TAX

NATURE OF TAXATION.—A tax is a "compulsory contribution of the wealth of a person or body of persons, for the service of the public powers" (*Bastable*). The following points should be noted—

(1) A tax is *compulsory*. There are those who think that the income of the State might be derived from voluntary contributions. The whole theory of taxation, however, depends upon the fact that taxes are compulsory.

(2) A tax is a *contribution*. It is a deduction from the wealth of the payer and is used for the maintenance of the State.

(3) The contribution must consist of *wealth*, i.e. something of value which is the result of production

(4) The tax is paid by a *person* and is always a deduction from his wealth. It is always a person who is taxed and never a thing.

(5) A tax is for the *service of the public powers*. The services which are performed by the public powers have to be paid for, and the taxes are used to meet these payments.

CANONS OF TAXATION.—The following principles were enunciated by Adam Smith—

(1) **Equality.** "The subjects of every State ought to contribute towards the support of the Government as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the State."

(2) **Certainty.** "The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, and the quantity to be paid, ought to be clear and plain to the contributor and to every other person."

(3) **Convenience.** "Every tax ought to be levied at the time, or in the manner in which it is most likely to be convenient for the contributor to pay it."

(4) **Economy.** "Every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the State."

THE INCOME TAX.—The income tax of the United Kingdom

yields the largest amount of revenue of any single tax in the British system. It was first introduced in 1799 and remained in force until 1816. It was reintroduced in 1842 broadly upon the same lines, and has continued in existence ever since. Income tax is, therefore, in substance a permanent tax, but it is in fact reimposed annually by way of the Finance Act for a period of one year only.

The laws relating to income tax were consolidated by the Income Tax Act, 1952, and the income tax is now levied under a code consisting of that Act and subsequent amending legislation. A Committee appointed by the Government has been engaged in codifying the Income Tax Acts. The aim is to make the income tax law as intelligible to the taxpayer as the nature of the legislation admits, and, to this end, the Committee is to suggest any alterations which would promote uniformity and simplicity, while leaving substantially unaffected the liability of the taxpayer, the general system of administration, and the powers and duties of the various authorities concerned therein.

Method of Charge. Income tax is levied only on (*a*) income arising within the United Kingdom, irrespective of the nationality or the place of residence of the beneficial owner, and (*b*) income from abroad belonging to any person residing in the United Kingdom.

For the purposes of assessment, all chargeable income is classified according to source into five groups, or "Schedules."

Schedule A deals with income from the ownership of land, buildings or houses in the United Kingdom.

Schedule B deals with income from the occupation of land in the United Kingdom.

Schedule C deals with income arising from British, Dominion, or Foreign Government Securities.

Schedule D deals with—

(*a*) Profits from trades, professions, and vocations carried on in the United Kingdom.

(*b*) Interest dividends, and other annual payments.

(*c*) Income from abroad (except that charged under Schedule C).

(*d*) Income derived from any source not included in this or other Schedules.

Schedule E, "Pay as You Earn," deals with income from offices and employments.

Income tax is assessed each year for the "year of assessment"

commencing on 6th April, and falls into two parts: that charged at a standard rate, and that charged at higher rates. The former applies generally, the latter only to individuals with large incomes. In practice only the former is referred to as the income tax, and the latter is referred to as the sur-tax. A sur-tax payer is a person whose income exceeds the limit laid down. The sur-tax is administered under that name separately from the income tax, and it is more convenient to look upon it as though it were a separate tax. But in law both the income tax and the sur-tax form part of one tax, and indeed the sur-tax of an individual for any year represents, in strictness, the difference between the total tax payable by him and the tax chargeable at the standard rate.

Differentiation and Graduation of Income. In the case of individuals resident in the United Kingdom, discrimination is made between income earned by personal exertion and income not so earned. This is effected by giving an allowance at the standard rate on an amount equal to two-ninths of the first £4,005 of earned income, and of one-ninth on the remainder up to £9,945, giving a maximum allowance of £1,550. The allowance is not given to non-residents or to companies.

Companies are liable in all cases to income tax at the standard rate and, save in exceptional circumstances, are not liable to sur-tax.

Taxation at the Source. A special characteristic of the British Income Tax is that, wherever possible, tax is assessed upon and collected from the person through whose hands the income passes before it reaches the actual owner. The first receiver is entitled by law to recover the amount of tax paid by making a deduction from the income before passing it on to the owner. As an example, consider the case of a house let to a tenant. Although the tax on the income arising from the ownership of the property (i.e. the rent) is ultimately borne by the landlord, the person assessed is the tenant who is bound to pay the tax charged. When paying the rent, the tenant deducts therefrom the tax paid by him. In the same way, the landlord is entitled to deduct from any payment of ground rent, or mortgage interest secured on the property, the amount of tax appropriate to such payment, since this tax has already been paid to the Inland Revenue by the tenant. Thus, by means of one assessment, Income Tax is collected from the landlord of the house, the ground landlord, and the mortgagee.

COMPARISON OF CERTAIN TAXES IN THE LIGHT OF ADAM SMITH'S CANONS OF TAXATION

Tax	Equality	Certainty	Convenience	Economy
Income Tax.	This tax is one of the most equitable devised. The system of exemptions and rebates relieves the poorer classes.	Calculation of the tax is often complicated so that this canon is often infringed.	The time of collection is known to the payer; indeed for many people it is now collected at source by deduction from wages and salaries.	In general it may be said that the tax is economical to collect.
Customs Duties.	They press more heavily on the poorer classes than on the rich, e.g. duties on tobacco.	The tax is certain and easy to calculate.	Goods may be stored in bond, and payment made when convenient.	Collection is fairly economical, though an elaborate supervision of imports is necessary.
Estate Duties.	They are graduated so as to press most heavily on the wealthy.	The amounts which are levied are certain and may be calculated with little difficulty.	The tax is levied when estate passes so that the time may be said to be convenient for payment.	They are economical to collect.
Stamp Duties.	Certain of these are graduated on an ad valorem basis, but others (e.g. receipt stamps) are very unequal in their incidence.	The taxes are easily assessed.	They are paid at a convenient time when sums of money are being transferred.	They are easily collected.

Again, a limited liability company carrying on a trade is assessed and pays tax upon the whole profits it makes, without regard to the manner in which those profits are distributed. Dividends and debenture interest are paid less the amount of tax appropriate thereto, so that the tax payable by the shareholders and debenture-holders is collected through the company.

The advantage of the system is that it greatly reduces the number of assessments necessary, and limits the possibility of evasion. The principal disadvantage is that it gives rise to a large number of repayment claims by persons entitled to relief.

"Pay as You Earn." The P.A.Y.E. system was introduced on the 6th April, 1944. The employer is responsible for calculating and deducting the income tax from the wages of his employees each week. He is notified by the tax authorities of the employee's Code Number, and by consulting the official Tax Tables, he is able to make the appropriate deduction which he records on the employee's Tax Deduction Card.

Before P.A.Y.E. was introduced, the deduction of tax always lagged behind the earnings on which the tax was assessed, and this meant that sometimes the tax on high earnings had to be deducted from low earnings, or if the employee ceased work, an arrear of tax remained outstanding. This is remedied by the new system, which disposes of the income tax bill week by week, and if through a change in the employee's circumstances the tax already paid exceeds the true liability, he receives an automatic repayment.

Personal Reliefs. A person whose net statutory income does not exceed £180 is entitled to total exemption from tax. In order to graduate the amount of tax payable according to the financial position of the individual, certain personal allowances are granted varying with the circumstances of each taxpayer. The reliefs are not granted to an individual who is not resident in the United Kingdom unless he is a British subject or resides in the Isle of Man, or the Channel Islands, and then only to the extent of the ratio between his British income and his total income.

(*a*) *Earned Income Allowance.* The Act provides that income earned as a result of personal effort should be relieved from tax to a greater extent than any other kind of income ("investment" income). This relief is covered by the two-ninths and one-ninth allowances referred to.

(*b*) *Age Allowance.* A similar allowance is granted in respect of investment income where a taxpayer (or his wife) was at the beginning of the year of assessment 65 years of age or more, and whose total statutory income does not exceed £700. As the tax payable by an individual whose income slightly exceeds £700 might be disproportionately large compared to that payable if the income were slightly under this figure, a "marginal" relief is granted, so that the tax shall not exceed—

(1) The tax which would have been payable if the income was exactly £700, plus

(2) three-fifths of the amount by which the income exceeds £700.

(*c*) *Personal Allowance.* The personal allowance is £240 in the case of a man who has a wife living with him or whose wife is maintained by him by means of an allowance from which he is not entitled to deduct tax, and £140 in all other cases.

Where the £240 allowance is made, and the wife has any earned income of her own, an additional allowance is made equal to seven-ninths of the wife's earned income, subject to a maximum allowance of the tax on £140.

(*d*) *Housekeeper Allowance.* This allowance, which amounts to £60, may be claimed by—

(1) A widower, or widow, who has a female person resident with him or her to look after his or her children, or to act as housekeeper.

(2) An unmarried person who maintains a female relative resident with him to look after his younger brothers or sisters in respect of whom he has been granted child allowance.

(*e*) *Child Allowance.* Any person who has a child or children (including adopted children and step-children) under eleven years of age is entitled to an allowance of £100 for each child. For a child between 11 and 16 the allowance is £125. The allowance, increased to £150, is also granted if the children are over sixteen years of age, but are receiving full-time education at a recognised educational establishment or an apprenticeship for a period of at least two years.

It is not essential that the person should be maintaining the child, or having the custody of it (except in the case of an adopted child). No deduction can, however, be allowed if the child's income exceeds £85, excluding income from any scholarship.

(*f*) *Dependent Relatives.* An individual is granted an allowance of £60 if—

(1) He maintains a relative of himself or his wife, and

(2) the relative, except a widowed mother, is incapacitated by old age or infirmity from maintaining himself, and

(3) the relative's income does not exceed £165 per annum.

If more than one individual contributes to the maintenance of the relative, the allowance is divided proportionately between them. An allowance of £40 is given to an individual who maintains a daughter living with him on account of his old age or infirmity.

(*g*) *Rate Chargeable.* For the year 1957–58 the first £60 is charged at 2s. 3d. in the £, the next £150 at 4s. 9d. in the £, the next £150 at 6s. 9d. in the £, and the remainder at the full standard rate of 8s. 6d. in the £.

(*h*) *Life Assurance Relief.* Relief is granted in respect of premiums paid during the year of assessment by an individual or his wife for an insurance or an annuity on the life of either. So much of the premium on any particular life policy as exceeds 7 per cent of the sum assured at death does not rank as allowance.

Where there is no sum assured at death, as in the case of an annuity, only policies or contracts effected on or before 22nd June 1916, are taken into consideration, and then only to the extent of £100 of premiums in the aggregate for all such policies.

After these adjustments, the total premiums are subject to a further restriction of one-sixth of the total income of the individual.

Returns of Income. Every person chargeable to Income Tax must, when called upon to do so, make and deliver to the authorities a return of his total income. The return forms are normally issued in April, i.e. at the beginning of the year of assessment. The taxpayer is naturally unable to estimate accurately what his income will be for a year which has only just commenced, but assessments on untaxed income are normally based upon the amount of income arising in the year preceding the year of assessment. In a return, therefore, for the year 1957–58, the taxpayer is required to state his total income for the year 1956–57, ended 5th April, 1957. He is also required to notify any changes in the sources of his income that took place during that year. A section is also included in the form to enable the taxpayer to claim his personal reliefs.

Statutory Total Income. The total income shown on an individual's

return has no relation to his statutory total income, either for the year of assessment, or for the preceding year. The statutory total income for any year of assessment is arrived at as follows—

(*a*) All assessments for the year upon untaxed income and property, plus

(*b*) all taxed income received during the year of assessment, minus

(*c*) all charges payable during the year of assessment (i.e. annual payments from which Income Tax may be deducted, as explained on page 653).

Determination of Assessable Profit. The Income Tax Acts provide that profits assessable under Schedule D shall be computed for Income Tax purposes in accordance with ordinary commercial principles, subject to certain specific directions affecting the allowance of expenses. Thus, an expense is allowable as an Income Tax deduction only if it is wholly and exclusively incurred in earning the profit, and is not of a capital nature. The actual amount of the assessment, therefore, is rarely the amount which the proprietor would consider to have been earned.

The following expenses are not allowable as deductions in computing the assessable profits—

(1) Sums charged for drawings by proprietors, partners' salaries, or interest on capital.

(2) Annuities, royalties, and annual interest generally. (Tax on such amounts should be deducted before payment is made.)

(3) Sums paid as Income Tax under any Schedule.

(4) Sums expended in improvement of premises, or written off for depreciation of land, buildings, or leases.

(5) Losses not connected with, or arising out of, the business.

(6) Wear and tear of machinery and plant. A deduction from the assessment, may, however, be claimed under this heading.

The following expenses are allowable as deductions—

(1) Sums expended on repairs to the business premises.

(2) Bad debts, and doubtful debts, to the extent that they are estimated to be bad.

(3) Rent of business premises. If part of the premises is used as a residence, only the appropriate proportion of the rent is allowable.

(4) Obsolescence of plant and machinery. When obsolete machinery is replaced, an allowance may be claimed equal to the

subject, and also to consult the Finance Act of the current year for information as to prevailing rates of tax.

TEST PAPER

1. Explain the object of the Income Tax.
2. Name the various schedules and describe the purpose of each.
3. State carefully what is meant by "Taxation at the source." Illustrate your answer by reference to the schedules of Income Tax.
4. Enumerate some of the deductions which the merchant is allowed to make from gross profits in the preparation of his Income Tax return.
5. Give five items which are not allowed to be deducted from profits when preparing the Income Tax return.
6. What is meant by the "Pay as You Earn" income tax system?

CHAPTER LXIV

BANKRUPTCY AND LIQUIDATION

IT sometimes happens that a business man will find himself unable to pay all his creditors in full and his estate will have to be administered under the insolvency laws, so that his creditors may be paid as much as possible after the realisation of the assets. It does not necessarily follow that the debtor will be a bankrupt, as, for example, the realisation and distribution may take place under a *Deed of Arrangement*, but it is possible for the estate to be dealt with under the Bankruptcy Acts. To achieve this an application must be made to a Court having power to administer the Bankruptcy Acts to make the necessary orders. In the provincial districts of England this power usually rests with the County Courts, and in the Metropolitan District the High Court carries out the work.

THE RECEIVING ORDER.—A creditor may petition the Court to make a receiving order against a debtor, but before he can do so with success, he must satisfy the Court that he has a claim of not less than £50 which he is entitled to collect, and that his debtor has committed what is called an *act of bankruptcy*; that is to say, an act on which a petition may be founded.

The more usual acts of bankruptcy are—

(1) The announcement by a debtor, to his creditor, that he is unable to pay his debts in full.

(2) An assignment of his property to a trustee for the benefit of creditors; or if he makes any fraudulent gift or transfer of his property or any part of it; or if he fraudulently prefers one creditor to his others.

(3) If, with the intent to defeat or delay his creditors, the debtor leaves, or remains out of England, or adopts any plan to avoid his creditors as when he absents himself from his dwelling-house, or shuts himself up in his dwelling-house and refuses to see creditors.

If the Court is satisfied that an act of bankruptcy has been committed, and that the petitioner is a creditor of £50 or more, a *Receiving Order* will be made, unless the petition is defeated when heard. Generally speaking, the Courts resent being used as a debt-collecting machine, and, therefore, it is a bad policy to receive anything on

account of a debt when once bankruptcy proceedings have been started. Not only will it invalidate the claim by altering the amount owing, but the probability is that, if it can be shown that the creditor petitioning for a receiving order is really seeking his own advantage and not the interests of the creditors in general, the receiving order will not be granted. The object of bankruptcy is to provide a means by which the available property of the debtor may be divided properly among all those who claim to be creditors.

Effect of Receiving Order. The effect of the receiving order, when granted, is to place an official known as an *Official Receiver* in possession of all the property of which the debtor is possessed, except property of which he is only the trustee. The debtor must also be allowed the tools of his trade, and the necessary wearing apparel and bedding of himself and his family. This illustrates the principle that it is against the interests of the community to deprive a person of all means of making a livelihood.

Of course, a debtor may himself petition the Court for a receiving order when he is in difficulties, and, in this case, the order will usually be granted. The effect is to put the Official Receiver in possession of the debtor's property. The Official Receiver is an officer of the State, and acts under the general control of the Board of Trade, by which he is appointed, but he is also subject to the directions of the Court. It is the Official Receiver's duty to take possession of the estate of any person against whom a receiving order has been made, and from that moment onwards—

(1) No one can effectively deal with the property except the Official Receiver.

(2) No one, other than the Official Receiver, can give a valid receipt on behalf of the debtor—not even the debtor himself.

(3) No one can get a valid title on buying a bankrupt's property except from the Official Receiver.

(4) Anyone trying to interfere with the Official Receiver in the execution of his duties can be charged with contempt of Court.

The Official Receiver collects the debts and realises the assets, and, after discharging the expenses and fees, distributes any balance amongst the creditors who have proved their debts.

Proving a Debt. A creditor must take steps to prove his debt as soon as possible after the granting of the receiving order. He must submit an affidavit showing the amount of, and consideration for,

his claim, and must submit any necessary documents in evidence, e.g. promissory notes. When the creditor is a limited company the proof must be made by some authorised agent on behalf of the company, for a company can act only through agents, e.g. the Secretary or Managing Director. The Official Receiver (or Trustee, if one is appointed to act instead of the Official Receiver by the creditors at their meeting) must give his decision on all proofs received, within twenty-eight days, but the decision is subject to revision by the Court, if necessary.

LIQUIDATION.—A company when once incorporated under the Companies Act, 1948, cannot be brought to an end except by removal from the Register of Companies on the ground of its being a defunct company, or through the machinery of winding up. The name of a company will be removed from the Register if no returns have been made and the Registrar is satisfied that the company is defunct.

A company may be wound up in one of three ways—

(1) Voluntarily—without interference of the Court.

(2) Compulsorily—by order of the Court.

(3) Voluntarily—subject to the supervision of the Court.

Voluntary Liquidation. This is by far the most common method of winding up; about 90 per cent of companies that come to an end are wound up in this way. It is commenced, in every case, by the company passing an ordinary resolution, if the time for the company's duration has expired; or an event provided for by the Articles has occurred; or, an extraordinary resolution if the company cannot carry on business because of its liabilities; or, in any other case a special resolution.

If the directors are of the opinion that a company can pay its debts in full within twelve months from the commencement of the liquidation, a majority of the directors, or the two directors if there are no more, may declare and file with the Registrar of Companies a declaration to this effect. The liquidation will then be conducted as a "members' voluntary winding-up," but if no declaration is filed, then as a "creditors' voluntary winding-up."

Members' Voluntary Winding-up. A liquidator is appointed by the company at the meeting which is called for the passing of the resolution to wind up and at which his remuneration may be fixed. The creditors have no right to interfere until twelve months have

COMPARISON OF DIFFERENT FORMS OF LIQUIDATION

Form	Circumstances Under which Applied	Conditions Rendering it Desirable	Effects
Voluntary Liquidation.	(1) When the period fixed for the company's duration expires. (2) When the event which terminates the company's business occurs. (3) When by reason of the liabilities it cannot continue. (4) When the company for any reason requires a voluntary winding up.	When it is desired to dissolve a company amicably, whether solvent or insolvent.	(1) The company ceases to carry on business except for winding up purposes. (2) It remains a corporate body. (3) On appointment of the liquidator the director's powers cease. (4) Transfers are subject to the liquidator's consent. (5) If winding up lasts more than a year the liquidator calls meetings of the company at the end of each year. (6) The liquidator may settle the list of contributories, make calls and carry on the business for winding up purposes.
Compulsory Liquidation by the Court.	(1) When a special resolution of the company requires it. (2) When the company fails to commence business within one year. (3) When the company suspends its business for a year. (4) When the company is unable to pay its debts. (5) When the membership of the company falls below the legal limit. (6) When the company fails to file the statutory report or hold the statutory meeting. (7) When the Court is of opinion that it is just and equitable.	When the company becomes insolvent.	(1) The winding up order operates as a notice of discharge to all servants of the company because it affects the personality of the employer, the business being carried on by the Court. (2) All dispositions of the property of the company made between the commencement of the winding up and the winding up order are avoided. (3) A stay is put on all actions and executions. (4) The Official Receiver becomes the official liquidator, until another person is appointed.
Liquidation under supervision of the Court.	On application the Court can direct that the voluntary winding up proceed under its supervision.	When it is desirable to put a stay on all proceedings against the company or to appoint a representative of the Court to act with the existing liquidator.	The liquidator appointed in the voluntary winding up may exercise all his powers without the sanction of the Court, but subject to such restrictions as the Court may direct.
Reconstruction.	When a compromise between a company and its creditors, or a reorganisation of the company is desired.	When it is desired to raise fresh capital by issuing partly paid up shares in the new company in exchange for fully paid up shares in the old company; or where it is desired to rearrange the capital of the old company.	No member can be bound to take shares but each dissentient is protected and entitled to value. A scheme excluding the rights of dissentients is *ultra vires*. Compromises are binding if agreed to by three-fourths of the members or creditors, subject to Court's sanction.

passed, the conduct of the liquidation being in the hands of the members. This form of liquidation has been specially designed for the purposes of amalgamation and reconstruction.

Creditors' Voluntary Winding-up. The company must summon meetings of its members and creditors, the creditors' meeting to follow the members' meeting not later than the next succeeding day, by notices sent out simultaneously and the creditors' meeting must be advertised in *The Gazette.*

The resolution placing the company in liquidation is passed at the members' meeting.

A director must preside over the creditors' meeting, at which a statement of affairs and list of creditors must be produced. The creditors have the power to nominate the liquidator and conduct the liquidation, usually by means of a *Committee of Inspection.*

The liquidator disposes of the assets in the most advantageous way and distributes the proceeds, after payment of all the costs of the liquidation, in discharge of creditors' claims and the surplus, if any, to the members.

Compulsory Liquidation. This is commenced by a petition to the Court presented either by a creditor, a contributory, or the company itself. On hearing the petition the Court usually make a winding-up order and the Official Receiver is generally appointed Liquidator. The Official Receiver obtains a statement of the company's affairs and renders a report to the Court, and, if necessary, he may request the public examination of any person connected with the company; the Court having power to grant his request. The Official Receiver must acquaint all creditors with the financial position and attend to the winding-up of the company, unless a liquidator has been appointed to do this. When the affairs of the company have been wound up the Court may make an order that it be dissolved, and it is dissolved accordingly.

Liquidation Under Supervision. The Court may make an order that a voluntary winding-up shall continue but subject to the supervision of the Court. Such an order has the advantage of operating as a stay of any actions or executions pending against the company. Except in these respects, the winding-up remains a voluntary one. The Court does not actively intervene unless set in motion.

RECONSTRUCTION.—A large number of companies now wind up only to reconstruct. The reason for reconstruction is usually to

raise fresh capital. Reconstructions are carried out in one of three ways—

(1) By sale and transfer of the company's undertaking and assets to a new company, under Section 208 of the Act; or

(2) By sale and transfer under a power to sell contained in the company's Memorandum of Association; or

(3) By a scheme of arrangement, sanctioned by the Court under Sect. 206.

These different forms of winding up are compared in the table on page 678.

TEST PAPER

1. Does an insolvent person automatically become bankrupt?
2. State the ground on which a person can be made bankrupt.
3. What is meant by an act of bankruptcy? Mention any acts of bankruptcy.
4. Explain the effects of a receiving order.
5. What are the duties of an Official Receiver?
6. How does a creditor in bankruptcy "prove" his debt?
7. What are the chief duties of an Official Receiver?
8. You are a creditor of X and desire to present a bankruptcy petition against him. In what Court would you present it, and what are the essential requisites for the petition to be valid?
9. Explain three methods by which the existence of a company may be terminated in the process generally termed "winding up," pointing out the stages in which such methods are applied.
10. What is the difference between a members' voluntary and a creditors' voluntary winding-up?

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